

AMERICAN BANKING PRACTICE

A TREATISE ON THE PRACTICAL OPERATION OF A BANK,
INTENDED FOR STUDENTS, BANK EMPLOYEES AND OTHERS
WHO WOULD KNOW OF THE CONDUCT OF A BANK UNDER
RECOGNIZED AMERICAN PRACTICE, WITH WHICH
IS COMBINED THE NEGOTIABLE INSTRUMENTS
LAW, UNIFORM IN FORTY-SIX STATES

BY

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PREFACE

For a long time past there has been an apparent need for a treatise on practical banking that would give a complete summary of the operation of a bank in such form as could be used as a text for teaching.

While many excellent works have heretofore been written on both the theory and practice of banking, no one work has in itself adequately covered the subject, making necessary the use of several books in order to supply such information as the student requires. Moreover, no other work has attempted to weave into banking practice the Negotiable Instruments Law, so essential to bank operation. It has therefore been the aim to present a simple, yet comprehensive picture of the work of a bank in every detail.

The author wishes to make special acknowledgement to that splendid work recently issued by the National City Bank under the title *Practical Bank Operation*, from which many valuable suggestions have been obtained as to the conduct of a large institution. Supplementing his own experiences and observations with such information, he has attempted to present a composite picture of banking practice as it is now conducted under recognized American procedure. Credit is also due to the Irving National Bank of New York for the use of its forms.

W H K

ROCKVILLE CENTRE, LONG ISLAND,
October, 1921

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INTRODUCTION

In a study of the practical operation of a bank, we must have in mind two types of banking institutions (a) The bank of moderate size, which may be termed the "ordinary" bank, and (b) the departmental bank, which may be termed the "city" bank. The former will include banks whose assets run from a few hundred thousand to several millions. In such banks the work is done by a relatively few employees, each of whom performs several functions in the course of the day's work. For instance, in the ordinary bank, the bookkeeper will keep the general ledger and the loan records, figure discounts, draw cashier's checks, and reconcile the accounts with other banks. In the city bank there will be a general ledger bookkeeper, a loan clerk, and an auditing department, each with a corps of clerks doing one particular part of the work. But in so doing, these departmental clerks will do exactly the same work as the one man. Again, the ledger clerks in the ordinary bank will not only post the daily credits and debits, but will also make up statements and write up pass books, while in the city bank a department will be organized to write up statements and pass books, as a check upon the work of the bookkeepers.

In treating the work of a bank from its many angles, I have endeavored to draw a picture of the ordinary bank, supplementing this by reference to the practices in the larger ones. But, to repeat, the same work, in its fundamentals, is done in both. The difference lies solely in the number of people and departments required to carry on the fundamentally identical functions.

AMERICAN BANKING PRACTICE

CHAPTER I

THE AMERICAN BANKING SYSTEM

The American banking system will be most readily understood if we start with the "country bank," or, to use a better term the "local bank"¹ In practically every community numbering several thousand people there is the home bank organized by the local citizens to furnish banking facilities for the locality It has indeed been claimed with some justification that the remarkable development of all parts of the United States has been made possible by the assistance of these local institutions which even the remote farm districts of the South and West find profitable to maintain

Why Banks Are Organized.

There are four principal causes for the establishing of banks.

First, the need for banking facilities (a) As soon as a small community develops, people feel the need of a safe place to keep their money Business men and individuals find themselves in possession of money

¹ In using the term "country bank" the author follows the National Banking Act, which classifies banks in the national system into central reserve banks, reserve banks, and country banks (For details of this classification, see page 289) But to use a more dignified name, the term "local bank" has been selected, to distinguish the banks in the smaller places from those in the larger cities which act as reserve depositories for other banks As they are found in practically all localities whose population is sufficiently dense to form a community, the "local" banks are in the great majority

for which they have no immediate use; and in offering the protection of its vaults for the funds of the community, the bank fulfills its first and simplest function. (b) There is the need of facilities for the transfer of funds from place to place in the payment of debts. Communities are not sufficient unto themselves, and in their trade with the rest of the world, a medium of payment is required for which the checking function of the bank is admirably adapted. (c) There is the need for currency or paper money with which to carry on business which requires the use of cash as distinguished from bank credit. (d) There is the need of loans for local business purposes.

Second, banks are established by professional promoters, or in many cases by a local promoter, often an attorney, who sees an opportunity for a profitable business both for himself and the stockholders. These promoters select their field carefully and then take an agreed fee, although the Comptroller of the Currency will not now grant a charter where the new bank is so promoted unless convinced that a real need exists, and the fee for promotion is not excessive. In the case of local promoters, the advantages which accrue come naturally with the development of the bank. In these two ways hundreds of banks have been successfully started. A single case will illustrate the process.

A certain village of three thousand people had no bank. The nearest institution was three miles away, making it inconvenient for the people to transact their banking business. A lawyer, becoming impressed with this fact, proceeded to crystallize public sentiment, and in due course enlisted enough support to organize a bank with a capital of \$50,000, all subscribed by local people in small sums. He not only received his legal fees, but was made counsel for the bank, which within a

year had half a million in deposits, all gathered from the local field. The bank proved a most desirable client and a most beneficial institution for the development of the community. This is typical of a large number of banks that have been organized within the past quarter century

Third, and the most unfortunate reason of all for establishing a bank, is spite. In many instances the organizers have been connected with other banks, or as borrowers or depositors have been displeased with certain transactions and have formed a bank of their own. It is to be regretted that such banks were ever chartered, but in many cases they too have had a fair degree of success

Lastly, the desire on the part of one man for a bank office, such as cashier or president, has led to the establishment of new banks. Many institutions have been formed for the purpose of giving such a position to one of the organizers. This is not so common a cause as the foregoing, but it exists nevertheless

From a banking standpoint, however, only the bank which arises from a real need on the part of the public has a right to exist and claim public support and confidence. The other causes produce a multiplicity of banks, just as a difference of opinion as to religion produces a surplus of churches

But whatever the motive that prompts the organization of a bank, as soon as it begins to function it reaches out and connects with other banks, particularly in the large cities. Inasmuch as the local bank must by law keep part of its deposits in reserve, either in cash or in other banks, and must collect the checks deposited by its patrons, it establishes connections with the city banks. To these it sends its surplus cash from time to time, receives any needed cash in return, sends its checks

daily for collection, and through it lends out its surplus funds in the money centres

How a City Bank Serves a Country Correspondent.

To show how a local bank links itself with a city bank, the procedure of one bank will prove typical. Here is a bank in a suburban village. It receives from its depositors about \$50,000 a day, part in cash and part in checks. It finds that it receives more cash than local demands call for, and therefore ships by express from \$25,000 to \$50,000 a week to its city correspondent. The checks received on deposit are drawn on banks in all parts of the country. To collect these with its own machinery would be expensive and slow, and besides it has no facilities for such country-wide collections. Therefore it sends all its out of town checks to its city correspondent, which in turn makes the collections for it. When it needs silver or currency, it draws upon the city bank. If it finds itself in need of funds, it may borrow of the city bank. If it has surplus funds, as most banks have at certain times during the year, it will direct its city bank to loan the same for its account. If it needs information about a borrower, the city bank, through its credit department, will furnish it. Moreover, the local bank will draw interest on the balances maintained in the city bank, for every day they are deposited. The large city banks thus have thousands of bank clients whom they serve to the profit and satisfaction of both. The network of bank connections spreads all over the country, weaving the banks together into a harmonious system, unorganized by law, but held together by the binding force of service.

Supervision and Association.

The next stage of banking development involves questions of public administrative control and unifica-

tion In every state there is a department of bank supervision, by whatever name it may be called, such as "Superintendent of Banks," "Commissioner of Banking," etc., which supervises and examines the banks within its jurisdiction, and enforces the state laws pertaining thereto. The national banks are thus welded together and supervised by the Comptroller of the Currency.

There are also to be mentioned the various bankers' associations, as a rule found in each state, the American Bankers' Association, and the various clearing houses, which unify and harmonize the methods and practices of the banks that become members. These associations promote sound legislation and safe practices, develop the personal equation among men, and in the case of clearing houses, enforce rules that have the binding force of law.

Lastly, and most important, is the Federal Reserve System, treated at length subsequently, which federates all national and a large number of state banks and trust companies into a harmonious system which has aptly been termed the "greatest banking system of the world." This is the great governor of our financial engine. Being a bank *of* banks and a bank *for* banks, it does not deal with the public, but with banks only. It regulates interest rates, controls the supply of money, checks panics, standardizes banking methods and practices, and welds the country into a solid financial unit that works for the good of all. (See Chapter XIX for further treatment of the Federal Reserve Bank.)

As a matter of fact, all banks now enjoy the privileges and protection of the Federal reserve banks. If the bank is a member, it deals with the Federal bank direct, but if not a member, it deals with a city bank which is quite likely to be a member and through the city bank it receives indirectly many of the advantages en-

joyed by direct membership. For instance. A non-member bank is in need of funds. It may borrow of its city correspondent; and if the latter were not in position to lend, it in turn could borrow from the Federal reserve bank. In other words, the city bank passes the load along, just as the local bank passes its needs along to the city bank. And only when the city bank has obtained its full quota of loans from the Federal bank must it fail in its service.

CHAPTER II

THE FUNCTIONS OF A BANK

In the terms of the economist, the functions of a bank are those of deposit, discount and note issue. To the uninitiated these terms are more or less meaningless and can be understood more easily by a simpler treatment. The institution we commonly know as a bank performs many services for the public, all of which grow out of the three basic functions above mentioned. More tersely stated, these services are: (a) The receipt of funds for deposit and safe keeping. Out of this function grows what I like to term (b) the checking function, sometimes called the "exchange function." By this is meant the disbursement of the deposit funds as the depositor directs when he draws his checks. When a deposit is made in a bank, a *credit is created on its books*, and the bank is debtor to the depositor in the amount deposited. The depositor has the right to withdraw this deposit, or in other words, have the debt repaid him, on demand. But this demand more often takes the form of a *transfer of the credit* than it does the withdrawal of the cash itself. To illustrate I have a deposit of \$1,000 in a bank. The bank owes me that amount. It also owes other depositors, let us say, \$99,000, or \$100,000 in all. I therefore am entitled to $\frac{1}{100}$ of the total deposits. I draw my check to another depositor in the same bank, in the sum of \$500. He deposits the check and the bank takes away half my credit and transfers it to him, and he is now entitled to that much

more of the bank funds I have simply *transferred* my right. If the check were deposited in another bank, my bank would owe depositors that much less and the other bank would owe that much more. And so this checking function is merely the *transfer of rights* against banks, which rights, when redeemed in cash or its equivalent, are canceled.

When a deposit of cash is made in a bank, the owner of the cash takes a *bank credit* in place of his money, which credit he can more easily and more safely transfer than the cash itself. The use of the bank check has grown enormously of late years, particularly in this country, and it may now be said to be the most common and most perfect medium of exchange known to finance. It is *cheap to create*—merely the cost of the paper. It is *elastic*, in that the amount varies to suit the needs of the maker. It is *safe* to carry or transport, since it is a negotiable instrument and as such must be indorsed to make good delivery. It has “*earmarks*” and can be traced from its inception to its extinction, which is not true of money funds. When finally returned to the maker it becomes a perfect evidence of payment.

Inasmuch as the loaning function follows the deposit function, the bank must have adequate funds before it can make loans. When a bank starts business it has merely its capital and surplus with which to work. But with this as a basis, it attracts other funds, called deposits, and these three—capital, surplus and deposits—are the loanable funds. Upon the faith that the bank has a capital and surplus fund, contributed by the stockholders, and is well managed and successful, the public will entrust its funds to the bank, which it in turn loans to borrowers, thus increasing its earning power, and enabling the bank to fulfill its discount function, mentioned under (c) page 11.

The Basic Principles of Banking.

It will be well for the student at the very beginning to understand the two basic principles underlying banking operations, and these are (a) That a dollar in money will support from four to ten dollars in credit, and (b) that a great part of bank deposits arises out of the proceeds of loans. In the first place, it has been found by long experience that only a certain portion of the depositors will demand that their funds be returned to them or transferred to others at a given time. And moreover, while some withdraw, others will deposit, so that there is a daily inflow and outflow of funds. And a little money goes a long way in clearing the transactions. For instance, in a bank of \$2,000,000 deposits, it has been demonstrated over a series of years that \$50,000 cash on hand and \$150,000 in reserve and payable on demand in other banks will be sufficient to clear all the daily transactions. Therefore, if the bank keeps a reserve of 10 per cent it is safe. On the other hand, it may safely lend out 90 per cent of all its deposits, or, to put it differently, for every dollar in money in hand it may expand its debts about ten times.

Deposits the Proceeds of Loans

When a loan is made, the proceeds are credited, as a general rule, to the depositor as a deposit would be, and he draws checks against the credit. Only those loans made to persons not depositors in the bank are paid in cash or by bank draft. The vast majority are treated as a deposit to be drawn against.

It is a rule of banking, quite generally recognized, that preference should be given to depositors in respect to loans. There are several reasons for this, among which are (a) Inasmuch as the proceeds of the loan are as a rule credited to the depositor's account, it increases

the deposits (b) The bank has intimate knowledge of the borrower's affairs and can lend intelligently (c) Having done the bank a favor as a depositor, the borrower has the moral right to expect favors in return, which may be stated in more dignified language thus. The deposits arise by virtue of those who have idle funds depositing them in the bank. The deposits of the public are thus "pooled" and from the pool the borrower draws when in need of loans. Those who have a surplus loan to those who can use the funds; and *unless the borrower contributes to the pool and helps create and maintain it, he has no right to borrow from it*. Therefore, banks favor their own depositors as against strangers in making loans.

Let us go a step further. Suppose it has been found that a reserve of 10 per cent is sufficient to carry the operations of the bank day by day. Therefore for every dollar the bank receives in cash, it may *create deposits from loans*, and while it may pay interest on one dollar, it draws interest on ten. *Banks expand and contract their loans according to the amount of reserve held*, and their deposits and loans therefore move up and down together. Upon the foregoing principles all banking rests.

The foregoing statement may be clarified by an example. Suppose a bank which carries a reserve of 10 per cent finds that its reserve is at that figure. With a reserve of \$10,000 and deposits of \$100,000 it can make no further loans, nor can it increase its deposits by crediting the loans as deposits. An application for a loan of \$10,000 is received from a customer who wishes the proceeds credited to his account, to be drawn against as needed. During the course of the day the cash deposits increase \$1,000, making the cash reserve \$11,000. It may then make the loan, credit the amount, \$10,000,

to the depositor, making the total deposits \$111,000. The balance sheet before and after the transaction will be

Before

	Cash	Deposits	Reserve
	\$10,000	\$100,000	10 per cent
After	\$11,000	\$111,000	10 per cent (approximately)

We have therefore maintained the proper ratio of cash to deposits and while we exact interest on \$10,000, we may only pay interest on \$1,000

In every bank, each morning, the ratio of reserve is known to the officers, so that the loans for the day may be regulated accordingly; and banks constantly have in mind the reserve ratio so that overloaning, as well as reducing the reserve below the standard to be maintained, is avoided. Practical application of the above rule is made in all banks in the daily conduct of the institution.

The Discount Function

(c) The discount function manifests itself in the discount of commercial paper (promissory notes) held by customers and sold to the bank, loans direct to borrowers, and loans secured by stocks and bonds, etc. This is more fully explained in Chapter XIII.

The Note Issue Function.

(d) The note issue function consists in the creation of currency or paper money. A study of the economic and historical side of finance will develop the point that the use of metal as money has proven costly and cumbersome, and all nations have substituted the use of paper representatives for metallic money as a safer and cheaper method of making monetary exchanges. Money in the

metal is stored and warehouse certificates in the form of gold and silver certificates are issued against it, thereby conserving the metal and expediting its use greatly

Banks have been given the right from time immemorial to issue their own notes—promises to pay—and secured in one way or another that need not be dwelt upon here Daniel Webster observed that the power to issue notes distinguishes a bank from all other forms of monetary institutions

* In the United States our bank notes are issued by the national banks and the Federal reserve banks In the former case the holder is secured by United States bonds lodged with the Treasury Department When a national bank takes out notes, it must deposit United States bonds of certain issues (not Liberty Bonds) in Washington, for which it receives the par value in national bank notes A national bank note is therefore simply a part of a United States bond, and is as good as the government that issued the bond The same comment applies to Federal reserve *bank* notes Federal reserve notes are issued by the Federal reserve banks and are secured in part by gold and in part by commercial paper (For further treatment see under "Federal Reserve Bank")

The other forms of paper money used in this country are Greenbacks—the promissory notes of the Government—and gold and silver certificates The latter are merely receipts evidencing the deposit of gold and silver with the Government, and are issued to conserve the use of the metal and avoid the inconvenience and dangers of handling precious metal Government paper money is, however, not to be confused with bank notes, which are primarily the obligation of the issuing banks, with proper backing as above noted.

The Trust Function.

(e) To the three *basic* functions¹ heretofore mentioned should be added the *fiduciary* function, which in short means "acting for others" Trust companies (which are banks under another name) have always enjoyed the privilege of acting as trustees of estates, registrars of stocks and bonds, transfer agents, executors of wills, administrators of estates, etc. This power has now been given to national and state banks, giving them all the privileges and powers heretofore enjoyed by trust companies

The corporate form of management for estates is fast coming into favor for many reasons, among which are—The corporation never dies. It has continuous existence. The corporation has experienced officers to handle such matters—men trained in law and finance. It deals impersonally with its clients, and has the benefit of cumulated experience that the individual lacks.

As a collateral function and part of the general scheme of banking, as at present carried on, a bank performs many other services for its people, such as collecting notes and coupons, bills of exchange, etc., furnishing credit information and reports, and acting as general business adviser and developer for its customers

All the banking operations revolve around these primary functions. The tellers and bookkeepers are performing the deposit function, the loan clerks, the discount function, the officers likewise are functioning in the discount section, while the cashier and officials who sign the notes are performing the note issue function. Everyone in the bank is connected closely or remotely with one of the divisions above treated.

¹ Deposit, discount and note issue

CHAPTER III

TYPES OF BANKING INSTITUTIONS

The banks of the United States may be divided into five classes (a) Banks of Discount otherwise known as "commercial" or "business" banks, (b) Savings Banks, (c) Trust Companies, (d) Building and Loan Associations, (e) Safe Deposit Companies.

The functions of a bank of discount are. To receive deposits against which checks are drawn, to make loans, and to issue currency, or bank notes. These functions, with the exception of note issue, are performed by both banks and trust companies, the note issue function being reserved to the national and Federal reserve banks. State banks are permitted, however, to issue notes, but the National Bank Act imposes a tax of ten per cent upon such issues and there have been no state bank notes issued for many years past.

The work of the savings banks and building and loan associations is similar, in that they both receive small deposits for investment purposes, and pay interest upon such deposits, making their investments as described later, while safe deposit companies are warehousemen for valuables only and do not do a banking business. We will treat each class of banks briefly at this point.

National Banks.

The national banks were the outcome of the Civil War. In the reorganization of our banking system following that event it was conceived that if a banking system could be devised that would afford a market for government bonds, it would not only sustain the credit

of the government but also furnish a system of bank note issue and banking facilities for the public. Therefore it was provided that all national banks should invest a portion of their capital in government bonds, which they were allowed to deposit with the Treasury of the United States and in return receive national bank notes, which they could put into circulation by lending out at interest, thus drawing income from two sources (*a*) interest on the bonds and (*b*) the loans.

Inasmuch as all national banks were obliged by law to invest in such bonds, it created a broad and steady demand for such securities and kept the price well above par for many years. This feature has been abrogated by the Federal Reserve Act, and national banks are no longer required to issue their notes, but a great many, if not most, of these banks still avail themselves of this privilege. Eventually all bank notes in this country will be issued by the Federal reserve banks (see Chapters XVIII and XIX).

State Banks

State banks are, as their name implies, under the jurisdiction of the various states. Each state has its banking act, under which banks are chartered with the powers of deposit, discount, and in many cases have recently been granted trust powers similar to trust companies. There is no essential difference between a national and a state bank, except in their supervision. The capitalization differs in the various states, and the laws regarding the amount of reserves to be carried also vary, but the difference is in degree and not in the principle involved. They also differ in the restrictions as to the amount they may loan, but this too is a technical and not a material difference. They report at various times to the state department having control

and are examined by state examiners. They may be distinguished from national banks by the token that all national banks are required to use the word "national" in their title, with the exception of a limited few which were allowed to leave the state jurisdiction and join the national system under their old names, using the initials "N. B. A." (National Banking Association) after their names. Thus, the Bank of New York, N. B. A.*

There is a widespread and common notion that national banks are superior to state banks and are in some way or other guaranteed by the Government. This is not so. Nothing pertaining to a national bank is guaranteed by the Government except its notes. To say that one is better than the other is a forced conclusion not warranted by fact. There are many state banks ranking as high as any national bank could ever rank, and *vice versa*. The supervision of the banking departments of some states is of such high order that all banks under such jurisdiction are inspected with a degree of excellence impossible to improve, and the banks so supervised are kept in as high a state of soundness as they humanly can be.

In both instances, national and state, the only guarantee of the supervising head is that due care will be taken to keep the banks healthy, sound and conservative, and to protect fully the interests of the depositors and stockholders, in so far as can be done from outside control. By a majority vote of the stockholders a state bank may become a national, thus allowing a change of administrative control should it be deemed advisable.

Trust Companies.

Trust companies were originally organized to act as trustees of estates and bond issues, executors, administrators, guardians, registrars of stock and bond issues,

* Some banks use only the initials "N. A." (National Association)

transfer agents, and what is broadly termed to exercise fiduciary functions. This has proven a highly profitable field, but gradually these companies began to assume banking functions also, except note issue, and they are now full-fledged banks, doing all that a bank of discount, a savings bank and a trust company can do. But inasmuch as other banks are now given the same rights in regard to fiduciary powers, there is little to distinguish one type of bank from another, except the savings bank, and this has adhered strictly to its original functions.

In many places trust companies have been the favored form of organization, on account of the broader powers enjoyed by them, and in large cities they are large and powerful financial institutions. A recital of the powers enjoyed by a trust company would be a lengthy résumé of the law and need not be taken up here.

Savings Banks

The term *savings bank* applies to any institution that accepts deposits for investment purposes, and which pays the depositors interest at stated times thereon. And inasmuch as a large number of banks of discount operate "savings" or "interest" departments, they are in a certain sense combinations of banks of discount and savings banks. But the savings department is incidental to their other business, and they are not regulated in the manner of their investments, as are savings banks.

There are two types of savings banks (a) Mutual and (b) stock. The mutual savings bank has no capital stock. It opens its doors to the public and holds itself out as an institution that will accept the deposits of all who offer, invest them according to law, repay on demand or upon certain prescribed notice and pay interest according to rules laid down in the by-laws. Savings banks are under state supervision. The administrators are termed "trustees" as distinguished from "directors"

of other banks, and usually serve for life. They are self-perpetuating, in that new trustees are selected by the old members of the board and there are no annual elections of trustees such as we have for directors in banks of discount and trust companies.

One of the distinguishing differences between the mutual savings bank and the bank of discount lies in the fact that the operations of the former are largely over the counter. Pass books containing the rules and regulations under which the bank operates are issued which must be presented at every deposit and withdrawal. Checks may not be drawn against these deposits. Collateral loans may be made upon such securities as the bank may purchase for investment, and in New York bankers' acceptances may now be purchased by the savings banks.

Aside from investments in legally designated securities, the savings banks are large lenders upon real estate security. They are in some sections the principal source of such loans, and in so doing materially build up their respective communities.

As a matter of fact, the savings bank depositor, in making the deposit, consents that the bank shall act for him as trustee in making loans and investments. He agrees to be bound by the rules as in force or afterward legally amended, and by accepting the pass book enters into a distinct contract with the bank, and the bank with him. In the bank of discount the relation is one of debtor and creditor, and the pass book is a mere memorandum of deposits received. It is in no sense a contract.

The Work of a Savings Bank.

The work of a savings bank consists in receiving and paying money, making loans and investments, collecting

the interest on investments, and computing and crediting the interest at stated times, usually semi-annually, together with the daily posting of the numerous deposits and withdrawals passing through

Strictly speaking, the savings bank is owned by the depositors, while the bank of discount and the trust company are owned by the stockholders. In the bank of discount the directors are allowed to receive fees for attending meetings, while in savings banks this is as a rule a gratuitous service, and is so provided for by law.

The investments of savings banks are limited by law to certain bonds and stocks and mortgage loans, while banks of discount have no such restrictions imposed upon them.

Stock savings banks are essentially banks of discount—state banks, with the word “savings” in their title. They are found principally in the west, and do a general banking business. They have capital stock, directors, receive deposits, make loans, collect checks, and are in no wise different from banks of discount in the same jurisdiction.

The savings bank is safeguarded by the fact that the payments are made in person, and the bank has the test questions, such as residence, age, birthplace, father's and mother's name, etc., on the signature card as identification in making payments. The risk of forgery is nil in a savings bank, while ever present in the bank of discount.

The savings bank can suffer losses only by overloaning on real estate through excessive appraisal of property, which risk is slight, and such losses are rare and infrequent. The bank of discount loans upon open credit, on the general credit worth of the borrower, and the risk is far greater than a savings bank could ever assume. The losses, in respect to depreciation of securities.

are as a rule paper losses only, and recovered when the bonds mature.

Building and Loan Associations.

The building and loan association performs a most helpful function in the financial scheme. It receives deposits from the public and loans the funds upon first mortgages only. The individual joining an association of this kind agrees to make periodical payments, weekly or monthly for a certain time, the pledge being in the form of a subscription to "shares." Thus if the par value of the share is \$100, the agreement would be to pay for the same within a certain time by monthly installments. The profits of the concern are distributed as "dividends" and are either added to the par value or shorten the time of payment. In some concerns interest at a given rate is paid, the same as in savings banks, while in others the dividend rate varies with the earning capacity. These institutions in some sections have been very popular and profitable. Their scheme of operation is exactly the same as if a depositor in a savings bank were to agree to deposit a certain amount weekly or monthly until the amount reached a certain sum, with or without the interest accretions. Withdrawal of funds may be made upon giving proper notice. When the amount is fully paid in, the whole amount is refunded.

Those who borrow from the association for building purposes do so upon mortgage security, and are called "borrowing members." These institutions are allowed a wider margin for loans than savings banks, often running as high as 75 per cent of the value of the property.

Therefore, if the borrower has 25 per cent of the probable cost of a structure and the land, he may borrow the

1est. Payments are made the same as in non-borrowing accounts until the amount paid in equals the amount loaned with interest. The advantage of this method of borrowing lies in the fact that the borrower liquidates his loan by monthly payments, which include the interest and a part payment on the principal. The loan is therefore constantly reduced until paid in full. Thus in borrowing a thousand dollars, the agreement would be to pay \$20 a month for five years, which amount in the course of that time would give the association the proper amount of interest and payment of the principal in full. In technical language the mortgage is "amortized" over a period of years. If the payments were smaller, the loan would run longer and if larger, the period would be shorter. The chief virtue of this plan is the fact that the mortgage cannot be "called" and runs automatically until maturity without additional cost for renewal. It gives the borrower more at the beginning, but compels him to reduce the debt systematically, making the loan better as time goes on, and is the perfect way for mortgage loans.

Growth of Savings Banks and Building and Loan Associations.

The growth of these building and loan associations or co-operative banks, all of which have as their aim the promotion of home building on the instalment plan, proceeded at an unparalleled pace during the last six years, but, what is more noteworthy, the record for 1920, in spite of the business reaction, indicates it was the banner year of all.

Assets of the co-operative associations reached \$2,519,914,000 last year, a figure equal to 15 per cent of the total resources of all the national banks in the United States. In 1920 the deposits by members increased \$393,294,581, which was \$223,000,000 more than the greatest previous increase, \$170,000,000 in 1917.

Reports on the membership and assets of building and loan associations were first gathered in 1893. The following summary

sets out the growth up to 1914 and the increase for the six years since then, which was greater than for the twenty years before the war

	Number of Associations	Total Membership
1893	5,598	1,349,437
1914	6,616	3,103,935
1920	8,633	4,962,919

But the growth was not alone in the number of associations and the total membership. Total assets would have been larger owing to the greater number of members, but, as the following table indicates, there were more thrifty savers and also each account was \$70 larger than in 1914

	Total Assets	Per Capita Deposits
1893	\$ 473,137,454	\$350 62
1914	1,357,707,900	437 41
1920	2,519,914,971	507 75

It is probably true that the housing shortage had something to do with the rapid growth of assets and deposits during the war. But this alone does not account for the growth. The natural, thrifty habits of a large section of our population are reflected as well in the deposits of savings banks, which were

	Depositors	Deposits
1890	4,258,893	\$1,515,023,956
1914	11,109,499	4,936,591,849
1919	11,434,881	5,902,577,000

Comparative figures on savings banks for 1920 are not available, but it is safe to assume that \$6,000,000,000 at least was held by these institutions as deposits at the end of last year. The average account runs about \$520. The combined savings bank and building and loan growth therefore shows that as much was saved by the wage workers in the six years following 1914 as in the period three times as long before the war.¹

Safe Deposit Companies.

A safe deposit company is merely a corporation that owns a vault, and rents boxes and stores valuable articles. A large number of banks have installed safe deposit

¹ From the *New York Herald*

boxes in their vaults, which they rent to clients as an incident to their other business. Some have special vaults and some have organized separate companies which own the vaults and operate them in conjunction with the parent bank.

The price of these boxes runs from \$2 or \$3 upwards per year. The box renter has one key and the company or the bank holds the master key without which entry cannot be had. Thus it takes the two keys to gain access to the contents.

The chief risk in such an operation is wrongful entry; for it can readily be seen that to admit one not authorized to enter the box might lead to serious consequences and amount to theft with knowledge on the part of the company. Therefore, at the time of renting, explicit instructions are taken as to who shall enter the box, and a record is kept of who opened the box at the various times. Inasmuch as these vaults are massive and fire and burglar proof, they have fast found favor in the eyes of the public and are highly profitable. The installation cost is heavy, but the revenue is large in comparison with the outlay, and the cost of administration is low, since it requires only a few attendants to conduct the business. In large cities, where stock exchange houses are numerous, the securities are kept in the vaults of a near-by company, taken out in the morning and replaced at night, thus giving these firms the benefit of, it may be, a hundred-thousand-dollar vault for a few dollars per year. They have a peculiar place in the financial scheme of our business life.

Stock and Bond Brokers.

As part of our financial system, there should be mentioned the great bond and stock exchange houses which deal in stocks and bonds. These houses bring out new

issues of securities and buy and sell old ones, for both banks and private clients. They investigate each issue offered and an offering over their name is in most instances synonymous with quality. Through these two agencies banks are furnished with their investments and the needs of their clients are taken care of.

Of like character are the "commercial paper brokers" mentioned under Chapter XIV, who sell commercial paper to banks in all parts of the country and not only furnish these institutions with the very best of investments for short-time purposes, but also provide merchants and manufacturers with liquid and seasonal capital.

Mortgage Companies.

There should also be mentioned the mortgage companies that loan on real estate security and sell the mortgages to institutions and private investors with guarantee of payment. These companies do a large and profitable business, and bring the borrower and the lender together with perfect safety to the latter and satisfaction to the former. Their manner of loaning follows closely the methods of the savings banks, and they are generally connected with "title companies" which insure and certify to real estate titles. In many instances they furnish the title policies upon the strength of which savings banks and individuals make their mortgage loans.

Individual Bankers.

In many places, particularly the large cities, there are private banking houses, large and small, some of international fame. These firms receive deposits, to be checked against, make loans, buy and sell securities, and perform all the functions of an incorporated bank except as to note issue. Their operations which come

to the attention of the public more particularly are in relation to security issues. Such firms act as bankers to great railroad and other corporate interests, and underwrite and promote the sale of the various bond and stock issues put out by their clients. They deal in stocks and bonds in general for account of customers, and are combinations of bond houses and banks. They do not, however, transact a trust business such as trust companies and banks are allowed to do. Of such character are the houses of J. P. Morgan & Co., Speyer & Co., Spencer Trask & Co., Kuhn, Loeb & Co., and many others.

Private Bankers.

These are individuals who go into the banking business without the formality of incorporating, and are not under the control of the banking departments of the several states except where special legislation has been enacted for their control.

These concerns transact a general banking business, except note issue and trust functions, similar to incorporated banks. They receive deposits, both commercial and savings, buy and sell foreign exchange and steamship tickets, make loans and discounts, and are in substance unincorporated and uncontrolled banking concerns.

Many of these are of foreign extraction and in many cases they are little experienced in banking practices, and work upon the credulity of their fellow countrymen, whose confidence they enjoy. Some of these are ably managed and some are lax to the point of danger in the manner of their loans. So great became the danger of allowing these men to operate, that in New York State they have been placed under the supervision of the Banking Department, to which they make reports and by which they are examined at half yearly periods.

The New York law distinguishes "individual bankers" from "private bankers" for the purpose of segregation. The latter are under specific provisions of the law, which are intended to protect the public in dealing with them, while the former are given more latitude and are free from the minute exactions of the law. The reason for this course lies in the fact that the large concerns, such as specifically mentioned heretofore, do not solicit business from the public, are men of known worth, experienced and trained, and do business of a private or semi-private nature. The other class hold themselves out as bankers and in the eyes of the law need the controlling hand of the banking department to guide them into safe banking practices.

CHAPTER IV

DEPOSITS AND INDORSEMENTS

For a starting point from which to treat the practical work of a bank, we will select the opening of an account, which is obviously the first essential to a banking transaction.

The work of opening accounts in the bank of discount differs materially from that of a savings bank. In the latter it is done at the windows, and impersonally; while in a bank of discount the new depositor is, as a rule, first interviewed by an officer who may delegate the work of making out the pass book and signature card, and furnishing the customer with check book, to a junior clerk. The bank of discount does not accept accounts from whomsoever offers, for the placing of a check book in the hands of one inclined to be tricky is a dangerous thing, and such banks safeguard themselves by requiring proper introduction of new depositors. Moreover, the officers desire to establish the personal point of contact with the customer, and it may be, arrange for a line of credit.

The customer usually signs two or three signature cards for use in different departments.

At this time the minimum balance required will be explained to the customer, the interest, if any, arranged for, statement taken for borrowing purposes, and future business relations discussed.

In the case of partnerships, the partnership agreement will be required or certificate of the agreement as to who shall draw checks, sign notes, etc. Some partnerships

require both signatures, while under the general law of partnership either partner may do any act within the scope of the partnership undertakings, and both are held.

NEW ACCOUNT	
Name	<u>Johnson, Evans</u>
Address	<u>220 B'way, N.Y.</u>
Date	<u>10/12/21</u>
Opened for \$ <u>1.000</u>	
Savings	Acknowledged
Checking <input checked="" type="checkbox"/>	<u>10/12/21</u>
Safe Deposit	Stencil made <input checked="" type="checkbox"/>

FORM 1—New account record

In the case of corporations, the by-laws or extracts therefrom will be required, together with resolution by the directors authorizing the opening of the account

CLOSED ACCOUNT	
Name	<u>S. W. Jones</u>
Address	<u>100 B'way, Bklyn</u>
Date closed	<u>10/29/21</u>
Closed for \$ <u>328.97</u>	
Savings	Letter <u>10/30/21</u>
Checking <input checked="" type="checkbox"/>	Reason <u>Leaving town</u>
Safe Deposit Box	Card Removed <u>11/1/21</u>

FORM 2—Closed account record

and giving the names of the officers authorized to sign checks, execute notes and make indorsements. This is usually provided for by certificate of the secretary, giving the procedure under which the bank may safely act.

In estates, the certificate of appointment of the executor or administrator will be required

In agency matters and accounts under power of attorney, due authorization from the principal to the agent or attorney will be necessary. In short, the bank must be protected by having proper authority to receive and disburse funds, which authority must be in writing and cover the business relationship created by opening the account

In receiving items on deposit this Bank obligates itself only as the Depositor's collecting agent assuming no responsibility beyond carefulness in clearing correspondence and until such time as actual payment shall come into its possession, reserves the right to charge back to the Depositor's account any amounts previously credited.

IRVING NATIONAL BANK, NEW YORK

John D. G.

FORM 3—Pass book Note the arrows

Check books are generally furnished gratis, together with the printing of the depositor's name on the stub and numbering the checks. Where special forms are desired, there may be a small charge to cover the added expense, but gratuitous stationery costs the banks a goodly sum each year and is part of their uncompensated service.

The Receiving Teller

The receiving teller is charged with the duty of acknowledging the receipt of deposits offered by the bank's

customers by entering the same in the pass books, and proving the deposit tickets. His department is the great reservoir into which are poured checks and money in a steady stream, there to be sorted and sent out in various directions as hereinafter described.

His risks are two. First, receipting for that which he does not get, and, second, accepting something which is bad, whether it be counterfeit money or a bad check. To guard against bad money, he must learn to know good money from bad, and this can be acquired only by experience. A few fundamental rules will be found helpful. The paper used by the United States Government for all paper money issued by itself, the national banks and the Federal reserve banks, together with the paper used in printing the Liberty Bonds, is made by one concern, under a secret process, which has never been successfully counterfeited, although it has been imitated.

Throughout the fiber of the paper will be found fine silk threads of various colors, principally blue and red, and these threads will be found in all genuine paper. Every sheet is accounted for from the time it leaves the mill until it is issued as money from the government office.

If these threads can be picked out with a pin, it is fairly safe to assume that the note is genuine, although counterfeits have been issued that were printed on two pieces of paper, the silk thread being sprinkled between the pieces, which were then pasted together. Such bills will split at the edges. These lines are also sometimes put in with ink.

The general appearance of the bill is also a safeguard. Genuine bills are finely engraved, the printing is clear and distinct and the lathe work is perfect. Counterfeits are usually reproductions by one process or another, and are generally blurred and lack the fine lines in their

perfection as found in genuine bills. Infrequently the work is done by an expert engraver, and then the work is well nigh perfect and hard to detect, although there is usually some defect made through carelessness. When the teller is in doubt, he turns to the "Counterfeit Detector" issued monthly by a publishing house, which gives all counterfeits with a description of the defects. This concern also issues postal notices on all new counterfeits discovered.

Paper money is often raised by cutting out the figures of large bills and inserting them in the small ones, without altering the lettering in the body of the note, and these often pass current until caught by some alert teller who takes in the whole bill at a glance. Such counterfeits are exceedingly clumsy in their conception and deceive only the unwary. Inasmuch as only parts of the larger bills are cut away, the face value of the bill is not destroyed and it may be redeemed in full.

Silver money and nickels are counterfeited in large quantities and may be detected by the color, the ring and the "feel," which is "leady." A simple test for silver is as follows

24 grains silver nitrate
30 drops nitric acid
1 oz. water

If the coin turns black, it is bogus.

For gold.

$6\frac{1}{2}$ drams nitric acid
 $\frac{1}{4}$ diam hydrochloric acid
5 drams water

How to Count Money.

Counting money is a fine art and acquired by few outside banking circles. To the average man it is a crude and cumbersome process. A few hints will be in place:

1. Never count money with dry finger tips and never wet them in the mouth.

2. Count by units That is, if you are counting \$5 bills, count twenty and make a pile of \$100, if counting \$10s, count ten, etc *

3 Take a pile of bills about half an inch thick, grasp them between the thumb and first and second, and if desired, third fingers of the left hand. Bend bills slightly in the middle With the thumb, push the top bill away from the rest, restraining it with the other fingers, so as to separate it from the others. Grasp the bill with the thumb and first finger of the right hand Pull the left hand slightly away to the left and drop the bill on a pile under the right hand Make as few motions as possible. Move both hands but little, and look at the denomination of the bill before it leaves the left hand A little practice will make a rapid and accurate counter

After bills are counted they should be strapped in standard packages, and counted by another person after strapping, by "thumbing"—that is, "picking up" the bill between the thumb and first finger and turning it back. Packages should be dated and initialed by those responsible for the count *Always pass them through two counters before paying out*

Strapping is done as follows:

50 bills of \$ 1—	\$ 50
50 bills of 2—	100
50 bills of 5—	250
50 bills of 10—	500
50 bills of 20—	1000

Silver is wrapped as follows

Pennies	—	50 cents to the roll
Nickles	—\$ 2	to the roll
Dimes	— 5	to the roll
Quarters	— 10	to the roll
Half dollars	— 10	to the roll

* In counting a mixed lot, count a \$5 bill as $\frac{1}{2}$, a \$10 as 1, and a \$20 as 2

Cash Items.

The bank receives three kinds of instruments besides money at its receiving windows. (a) Cash items These are checks drawn on the bank itself and banks in the same locality clearing through the clearing house or collected by messenger and paid the next day, and which are regarded in the same light as cash itself. (b) Other checks for which immediate credit is given, but which may not be paid immediately, since distance makes this impossible The right to draw against these latter items is generally restricted, as will be seen under "Uncollected Funds," but they are received as a cash deposit with a "delayed credit" (c) Time items, or collection items, which must be presented at a certain place at a certain time for payment, and the element of time is the essence of the instrument These are *collected* and *credited* as distinguished from *credited* and *collected*. Of such are notes, drafts, coupons, etc., more fully described under "collections"

To handle these items properly the bank employs a receiving teller to handle the cash items, and a collection teller to handle the time items In the large banks many of the deposits are made by mail, which forms a very important part of the clerical work This department is called the "Mail Teller" and it handles only those items received through the mail

Generally the receipt for the deposit takes the form of an entry in a pass book, which is presented to the teller at the time of deposit Where deposits are made by mail, an acknowledgment slip is sent, and where the book is not presented, a duplicate slip is stamped as evidence of the receipt of the amount Frequently firms having branch houses deposit funds in local banks and check the amounts out from a central office In such cases the home office desires advice of all deposits, which is mailed

to it as deposits are made. Quite generally branch stores have no right to draw checks against the funds received by them, all such matters being handled at the head office.

The Deposit Ticket.

It is necessary that somewhere in the receiving operation the deposit ticket and the cash and checks offered for deposit must be compared in order to detect errors. It will be remembered that the receiving teller can only err by receipting for that which he does not get, or receiving something which is bad or irregular.

It is obvious that if the teller were to examine the checks and compare them with the ticket, and count the money, the line would be held up unduly. Therefore, in the large banks, the work of proving is done by other men away from the window. The deposit is received subject to proof, and any irregular item is charged back, and any errors found in the ticket are corrected.

As a rule only the indorsement of the depositor is examined, to see that it is on the checks deposited, leaving the work of stop payments, short funds, irregularities in the checks, etc., to be detected subsequently. The reasons the indorsement of the depositor is necessary are two. First, to trace the ownership of the checks; and second, to have the right under the indorsement to charge an item back should it be returned unpaid.

Inasmuch as it is needful at times to trace a check, we must have some history of it in the bank. To record details of every check passing through a bank of ordinary size would be difficult and in large banks utterly impossible. But enough may be taken by brief figures to identify and trace any check which the bank handles.

Transit Numbers.

Beside the name of the bank on each check will be

found a compound number. This is the number assigned to the bank by the American Bankers' Association, and is called the "transit number" In large

In receiving items on deposit this Bank obligates itself only as the Depositor's collecting agent, assuming no responsibility beyond carelessness in settling correspondence and until such time as actual payments shall have come into its possession reserves the right to charge back to the Depositor's account any amount previously credited.

DEPOSITED BY
John Doe & Co.
 IN THE
Irving National Bank
 Woolworth Building

New York, 10/1 1921
 Payable in Greater New York

		Dollars	Cents
Coin,			525
Bills,		187	2
Checks,			
OUT OF TOWN ITEMS			10
Dollars	Cents	Dollars	Cents
			200
50	-		50
75	10		7510
TOTAL FOOTING		221	235

Form 4—Deposit ticket, showing segregation of out-of-town checks

cities the banks are given their clearing house number, with a prefix. Thus the Irving National Bank is "1-67," city number 1 being New York and "67" the

Irving's clearing house number. The wonder is that it took the banking world many years to discover that the number "2-27" could represent the Continental and Commercial National Bank of Chicago, as well as the lengthy name, provided all banks could know what

Bank of Rockville Centre.	
DEPOSITED BY	
<i>John Doe & Co</i>	
10/22/1921	
PLEASE DETACH CHECK SEPARATELY	
	DOLLARS CENTS
Gold	5
Silver	10 50
Bills	20 2
Checks	
1-45	10
1-216	5 75
50-HH4	9 72
60-55	10 28
2-15	12 75
2-69	80
Total \$	559 00

SEE THAT ALL CHECKS AND DRAFTS ARE ENDORSED

it can know what disposition was made of the item as it left its hands. And if the check should be lost, a duplicate can be obtained by the cooperation of the depositor.

In receiving and checking off the deposit items, many tellers place these transit numbers opposite the checks on the deposit ticket as shown in Form 5

When the check reaches the transit department or the transit desk, the clerk will take the indorsement on his sheet, and with these two clues we can trace every check handled.

The Purpose of Indorsement.

Anyone who holds a negotiable instrument drawn to his order or indorsed to him in due course and without fraud or error, and with the intent to make the payee or indorsee the owner of the amount represented thereby, has absolute title to the instrument. In order to get this title out of himself and into another, it must be indorsed—that is to say, the name of the payee or indorsee must be written on the back of the instrument with intent to transfer title. When this is done the one to whom it is transferred becomes the absolute owner of the same, but with certain rights against the indorser.

Unless the checks received by the teller are on his own bank, he has no way of telling whether they are good or not, and must rely upon the depositor to make good any check that may come back unpaid. To this end it is required that all checks be indorsed by the depositor, not only to trace the ownership, but to fasten the responsibility as a matter of law. The teller, therefore, examines all checks deposited to see that they are indorsed by the depositor, and it is here opportune to discuss the forms and legal effect of indorsements.

Forms of Indorsement.

Indorsement in blank Simply the indorser's name—"John Doe"

Special indorsement "Pay to the order of Richard Roe—John Doe"

Qualified indorsement "Without recourse—John Doe."

Restricted indorsement "Pay Richard Roe only—John Doe"

Restricted in trust "Pay First National Bank, for account of Richard Roe—John Doe."

Conditional indorsement "Pay Richard Roe, upon completion of his contract—John Doe" (see "Negotiable Instruments Law," Sections 33-39)

Warranty of Indorser.

Where a party indorses a negotiable instrument without qualification, he warrants

- 1 That the instrument is genuine, *i.e.*, that the signatures of prior parties are genuine.

2. That the instrument is in all respects what it purports to be.

3. That he has good title to it

4. That all prior parties had capacity to contract.

5. That the instrument at the time of his indorsement was valid and subsisting Thus he cannot claim that it was illegal or made on Sunday He contracts, in addition, "that on due presentment, the instrument shall be accepted and paid, or both, as the case may be, according to its tenor, and that if it be dishonored and the necessary proceedings on dishonor be taken (protest and notice of dishonor) he will pay the amount thereof to the holder or to any subsequent indorser who may be compelled to pay it." The indorser is also liable for interest and notary's protest fees ("Negotiable Instruments Law," Sections 65 and 66).

Charging Back Unpaid Checks.

When a check is deposited in a bank and drawn upon another bank and it is returned unpaid, the question arises, by what right can the bank rescind the credit already made? Under the law of indorsement as above stated we have seen that the indorser warrants that the instrument will be paid upon presentation and if not

Bank of Rockville Centre	
Rockville Centre, N. Y.	10/3/21 19
<i>John Doe & Co.</i> <i>150 B. way NY</i>	
Dear Sir	
We enclose herewith { paid unpaid	
Check of	<i>Smith & Brown</i>
Note of	"
Reason Checked	\$100.-
DATE INSUFFICIENT FUNDS ✓ PAYMENT STOPPED SIGNATURE ENDORSEMENT MAKER DECEASED FILLING NO ACCOUNT DRAWN AGAINST UNCOLLECTED FUNDS CHARGED TO YOUR ACCOUNT	
BANK OF ROCKVILLE CENTRE	

FORM 6—Letter returning unpaid check

paid, and proper steps taken to charge the indorsers, he will pay it. Therefore, all checks that are returned unpaid are immediately charged back and the credit rescinded (See Chapter VI)

The indorsement in *blank* makes it a bearer instrument and payable to anyone who may hold it. It is not a safe form, although widely used. The *special* indorsement is

legally and practically correct and safe. It conveys title to one named, and he must in turn indorse it to make it negotiable. *This form should always be used*, unless for special reasons one of the other forms is desirable.

The *qualified* indorsement is used where it is necessary to indorse the check, but where no liability is assumed, beyond the fact that the check is genuine, not issued in fraud and is what it purports to be. For instance. If I were to receive a check made in my name in error and I wanted to pass it on to the true owner, I would use the *qualified* indorsement. Having received no value for it, I assume no financial risk on it. I simply say "Take it at your own risk, and if it proves no good, you cannot hold me." The *restricted* indorsement stops the further negotiation of the instrument.

The *restricted in trust* form is used where the check is deposited by one person for the account of another, and without the indorsement of the one receiving credit for the same. Thus, I hold a check to the order of John Doe, which I want to deposit to his account. He cannot indorse it, being out of town. I offer it to the bank, indorsed by me for the credit of Doe, and the bank will place it to his credit. These are sometimes called "third party indorsements."

Conditional indorsements are uncommon, and the transfer, of course, depends upon the fulfillment of the condition. A bank would not accept such a form (see under "Negotiation," "Negotiable Instruments Law").

Checks to Officers of Corporations.

One of the risks of banking is the deposit by an officer of a corporation of a check drawn by himself as an officer to himself as an individual and offered for deposit to his personal account. Many corporation officers draw such checks in due course of business and in perfect

good faith, and with full knowledge of the other officers. But it can readily be seen that such a practice opens the door to gross frauds, for the officer may abstract moneys from the corporation by such a process for a long time before it may be detected. And if the checks are deposited to his own credit in a bank, the bank has *prima facie* evidence of the fact and the law holds the bank liable to the corporation. While such checks are drawn for salaries, expenses, etc., the practice is one to be avoided, and a second signature or the authority of the corporation should be obtained to permit this irregular practice to continue.

The same holds true of executors and administrators, guardians, etc., depositing funds held in trust to their own accounts, or permitting notes made by themselves to be charged against trust funds. A bank cannot be held harmless when it has evidence of wrongdoing on the part of its customers.

Rubber Stamp Indorsements.

In the development of business, it has been found necessary for the law to recognize the fact that a business house cannot indorse its checks by hand. To do so would be needless waste of time and effort. And so the rubber stamp indorsement is recognized as proper, and is widely used by banks and business houses everywhere.

But there is a difference in depositing checks indorsed by rubber stamp and offering a check for cashing with a rubber stamp indorsement thereon. In the latter case the bank would ordinarily require a written indorsement (*Mayers vs McRimmon* 140 N. C. 640, *Evans vs Freeman* 142 N. C. 61).

Coupons.

The receiving teller receives many coupons from clients. Some are due and are received the same as

To	Transit Dept.						
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Thousands	Hundreds	Cents					
From	Paying & Receiving Teller A-D No 1 1						
Form 1535							

To	Note Teller						
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THOUSANDS	HUNDREDS	CENTS					
FROM	PAYING & RECEIVING TELLER A-D NO 1 1						
Form 1554							

To	Credits to Distributing Dept						
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Thousands	Hundreds	Cents					
From	Paying & Receiving Teller No 1						
Form 992							

FORM 7—Teller's report slips

cash, while others are not due and are received for collection. Since the Liberty Loans, Government coupons are handled by banks in great quantities. Coupons should be enclosed in envelopes furnished for the purpose, with the name of the company, the due date, place of payment, number of coupons, amount and name of owner. On account of the income tax laws, all coupons except those of Liberty Bonds and municipal bonds, which are tax free, must be accompanied by proper blanks, which banks furnish gratis to their customers. Coupons are sent out under registered mail and insured while in the mail.

Exchange.

Under the chapter "Exchange," the subject of exchange is more fully discussed. Suffice to say here that the exchange charges, if any, are sometimes deducted from the deposit before it is credited to the depositor, but more often they are figured in another department and charged back monthly. Therefore the items on the deposit slip must be segregated or classified for this purpose. This classification may be into "par" and "exchange" checks.

The Name on the Ticket.

The receiving teller is careful that the name on the deposit ticket agrees with the name on the book. Many depositors have two accounts and get the books confused, adding to the annoyance of making wrong credits.

Where the account is "Special" as many are, the ticket should be so marked. In other words, the burden should be upon the depositor to make his ticket exactly as he wants the credit made, and if error is on his part he has no one to blame but himself.

The teller courts the money, and prefers that the bills shall be in separate denominations, right side up, laid

flat in the book. Then he proves the silver and gold and lastly the checks. In many banks the teller simply makes the pass book entry and turns the proof over to his subordinates, in order not to congest the line.

The Block System.

If the teller were to wait until the close of business to prove his day's work, he would keep late hours. How much better to prove the work at short intervals, and in case error develops, it can quickly be located. Therefore we have the "Block System" to prove the work at various times during the day. In this case the teller simply proves the cash and turns the checks over to the proving clerks to examine for indorsements and correct listing. They do not compare the checks with the tickets unless there be error, or unless it is the custom of the bank to mark the deposit tickets for identification. Here, for instance, is the work of the first half hour of the day. The cash has been proven and the clerks find a hundred deposit tickets and a thousand checks before them. It is obvious that the sum of the checks must equal the total of the deposit tickets, minus the cash. Therefore they sort the checks into various classifications and make a total of each class. The deposit tickets are also added, the cash totaled from the tickets and a balance struck. If there are no errors in footing the tickets or listing the checks, the work will agree, if not, the error must be hunted down. This is called the "Block" or "Batch System."

Where large checks are received for deposit it is often advisable to get them moving toward payment without delay, and such items are taken out of the regular work and a ticket substituted. By prompt action the bank not only saves a day's time in interest, but also has advice of payment that much quicker.

The checks received for deposit will be sorted according to the following general classifications

1 Checks on itself—into as many groups as there are ledgers or groups of accounts

2 Clearing house checks—checks to be cleared the next day through the clearing house

3 Checks on other banks in the same place, to be collected by messenger

4 Checks on out-of-town banks, also classified according to the bank's peculiar arrangement

It naturally follows that the sum of all the classifications, plus the amount of cash received, must equal the total of the deposit tickets in the block under proof, and if no error exists in the footings of the slips, the counting of the cash or the footing or listing of the checks in the groups, the checks may go forward to the next process

Where the bank is a departmental bank, the checks, after grouping and proving, will be charged.

Own checks—to the bookkeepers

Clearing house checks—to the clearing house department

Messenger collections—to the collection department

Out-of-town checks—to the transit department

Cash—to the paying teller

In a small bank the departments may be simply desks, but the same work follows as in the departments of a large bank

Whatever the receiving teller turns over to other departments of the bank he "charges out" and they in turn credit him, so that when the day's work is all charged out, the total must equal the amount received as shown by the total of the deposits.

The Mail Teller.

The mail department receives all the mail and distributes it to the addressees. Bank mail is opened and

read and forwarded to the proper officer or department for attention, while letters containing checks and collection items are proven with their contents and these are turned over to the proper departments. The original letter is used as a ticket for posting purposes by the bookkeepers and acknowledgment is made from the original sources.

A mail teller is not found in the smaller banks, and even in some of the larger ones it is an incidental part of the work of other men. But by whatever name called, the mail work must be performed. Where this department exists, the mail is divided into the night, the morning and the afternoon mail, each being treated as a separate unit.

It being desirable to present all checks received during the day and night preceding in the morning clearing at the clearing house, it is necessary that the night mail be handled during the night as it comes in, so that by morning all checks in hand may go to the clearing house.

In New York there are two clearings, one at nine o'clock and the other at ten. Therefore the one object of the bank force is to get all checks into the clearings before ten o'clock. Otherwise they must wait over a day.

In fact, the mail is the great event of the day, and to this work the employees from all parts of the bank assemble to get it out of the way as speedily as possible. After the mail is opened, it is sorted for cash letters, collection letters, and general mail. As soon as a letter is turned over to a checker, he proves the listing of the checks, often by running them up on the adding machine, on the back of the letter. He puts a number or initial on the letter to indicate who proved its contents. After the letters are proven, they are turned over to the sorters, who sort them for credit to the senders, while the checks go to the check sorters who sort them for further handling.

The term "rack" will often be heard in banking circles, and this means a series of pigeon holes, used for sorting checks. The work of the mail department is proven by batches the same as deposit slips are proven at the receiving tellers' windows. Letters are no more nor less than deposit slips and are so treated.

Many of these letters contain a mixture of all sorts of items, cash, collections, coupons, etc., added into the footing or not according to the whim of the bank sending the same, and the time items must of course be taken out of the cash letters and turned over to other departments for attention. Notes, drafts, and acceptances would go to the collection department, coupons to the coupon collection department, and out-of-town items to the transit department.

There is a difference of opinion as to whether the indorsement of a check "for deposit" is a restrictive indorsement and vests title to the check in the bank. Probably the better rule is that such an indorsement creates more than a mere agency for collection, and that when a check is so indorsed and delivered to a bank, the title to the instrument passes to the bank. There are, however, cases which hold that the indorsement of a check "for deposit" to the credit of the indorser is a restrictive indorsement, and that such an indorsement indicates that the bank, to which the check is indorsed is merely a bailee of the check until it is collected, when the bank becomes the debtor of the depositor for the proceeds. In considering these indorsements it will be found that, where the depositor is permitted to draw before collection, it is generally held that title passes to the bank. (Brady, Law of Bank Checks, p 63.)

CHAPTER V

THE PAYING TELLER

The paying teller is generally the ranking teller and is frequently called the "first teller." He is custodian of the bank's cash. As it is received from the receiving teller it is proved and then placed in the vaults for future use. In many banks there is a reserve vault which contains the cash held in reserve and which is not disturbed except for audit purposes, or when the daily needs require an addition or a subtraction.

The current cash is kept separate and is the cash used for the daily payments. The combinations to the cash vaults are sometimes held jointly by two or more tellers, so that two men must be present when the vault is opened, while in others the combinations are known to several of the men. These combinations always are known also by some of the higher executives.

The paying teller is the disbursing officer of the bank, and all checks paid, whether over the counter or through the clearing house, go through his department. Shipments of currency to out-of-town correspondents also are made by him. The certification of checks, being essentially their payment, is likewise part of his work, as is the bank pay roll, which in some cases is in charge of a petty cashier who makes up the pay roll and distributes the salaries. The latter also pays the bills of the bank and has charge of the many petty expenses. We shall now discuss these functions.

The Bank's Cash

In the large banks the cash receipts are so heavy that they are taken direct from the receiving teller's

department and given to a "money teller" who does nothing but prove the cash. In many banks there are several money counters who do nothing but count money.

It is obvious that the handling of cash requires care, inasmuch as money, unlike negotiable instruments, has no earmarks and once its identity is lost it is difficult to trace, and errors cannot subsequently be corrected. Those who prove the packages initial them, and when

We, the undersigned, employees of the Irving National Bank, hereby certify that we have verified the package containing money	
RECEIVED FROM	<u>Bank of Rockville Centre</u>
and the correct amount contained in the package was \$ <u>490⁰⁰</u>	
Date	<u>Sep. 7/21</u>
	<u>John Storm</u> <u>Robert Smith</u>
Form 1928	

FORM 8—Report on discrepancy in package of money

money is passed from one department to another, proper receipt is taken.

Those who handle the cash of the bank are responsible for detecting counterfeits and spurious coin, and where cash is received from customers in packages, any shortage or irregularity is charged back to the customer. In the event of shortage, two men verify the package and certify in writing to its contents. In fact, money is always proved by more than one man in practically all banks, as it should be.

Mutilated coin and worn bills are taken out of the cash and replaced with new. Silver coins are current

even when worn; but gold coin below a certain weight is uncurrent, and where this is the case it is received at the mints at its bullion value only

Inasmuch as the public has a fondness for new money, all banks endeavor to keep their cash clean and crisp, and new money is constantly being exchanged for old Paper money, if partly destroyed, is redeemed by the Government according to the following rules. If more than two-fifths and less than three-fifths of the bill remains, it is redeemed at half its value, if more than

Vault Requisition for Cash					
This ticket must bear Teller's No., Date and Amount of denomination drawn, and initialed by Teller receiving same.					
Teller No. _____		COIN		BILLS	
192					
Cash				One's	
Nickels				Two's	
Dimes				Five's	
Quarters				Ten's	
Half's				Twenty's	
Silver Dollars				Fifty's	
Gold 2 50				Hundred's	
1 00				Large	
10 00					
20 00					

FORM 9 — Requisition for cash

three-fifths, at its face value. If less than two-fifths remains, the bill is worthless. If, however, a fragment of a bill remains and proper and satisfactory affidavit of the loss of the remainder is made, the Government will redeem the bill in full. The redemption and issue of currency is now performed by the Federal reserve banks, the sub-treasuries being closed as governmental agencies for such purposes

Under the old régime banks were required to carry a certain percentage of cash in their vaults as reserve, and this still obtains in the state banking systems, but under the Federal Reserve System the cash in the vaults of

national banks is optional and need only be sufficient to meet the demands of the bank's customers. How much or how little this shall be depends entirely upon the character of the business.

The Bank's Money Supply.

The bank's supply of money comes from (a) the daily deposits, payments on loans, collections, and in the city banks, from their country correspondents, (b) the receipt of new money from the U. S. Treasury in exchange for the mutilated, (c) the Federal reserve bank in payment for rediscounts, or as a draft on the member's balance. Where the bank is not a member of the Federal Reserve System, it depends upon its city correspondent for its money supplies, but in the case of a national bank, it receives its national bank notes direct from the Treasury Department.

The Paying Operations.

The paying operations of a bank follow closely those of the receiving. In some banks the receipts, in the form of cash itself, are insufficient to meet the demands for cash disbursements in the form of pay rolls, while in other banks the cash receipts are much larger than the paying operations require. Where the cash receipts exceed the needs of the bank, the excess is sent to the city bank or the Federal reserve bank for credit. In the latter case the expense is borne by the Federal reserve bank and in the former the bank must assume the cost of shipping.

The Tellers' Opportunity.

From the standpoint of its effect upon the business of the bank, no position in the institution is of greater importance than that of the tellers, both paying and receiving. They meet the public constantly and can capitalize their positions to very great advantage.

Personality counts for much in the cages. Good will can be built up at the windows faster than through any other medium; and it can be lost as fast. Cases are numerous where customers have been offended and lost to the bank permanently at some trivial happening that could easily have been avoided, and while it may be argued that people should not be so sensitive, the fact remains that they are. Hence, a little pleasantry, a smile, small courtesies willingly extended, like bread cast upon the water, have their sure return. Even so small a matter as making change or cashing a check can be, in the way it is done, a powerful stimulant in building up a bank. While the officers meet the borrowers frequently, and the depositors occasionally, the tellers meet both continuously. They are essentially the "good will men" of the bank.

The Paying Teller's Duties.

The duties of the paying teller may be divided into two general classifications: (a) The custody of the bank's cash, and (b) the payment of the checks drawn on the bank, or offered for cashing and drawn on other banks. As a matter of fact, a bank is under no obligation to cash a check drawn on another bank, and does so as a courtesy only. It is, however, obliged to honor the checks of its depositors when presented in due form and when the account is good for the amount.

The receiving teller turns over his cash to the paying teller, either at the end of the day, or as custom decrees, and the latter is responsible for its care and disbursement.

Bills are kept in strapped form and bundled in even amounts for quick proof and are often put up in convenient form for making up pay rolls. Silver is wrapped and stored in trays likewise for convenience in paying out, the reserve supply being kept in bags, loose

Procedure in Paying Checks.

Technically speaking, the paying teller examines every check paid by the bank, whether over the counter, through the clearing house or otherwise, although the detail work is often delegated to other men. He is the final arbiter as to the payment of these items, and every check passing through the bank and up to the bookkeepers for charging against the accounts of the depositors is examined for the following points

Date

The check must not be dated ahead, for if so, it becomes merely a time bill of exchange and cannot legally be paid until its date arrives. Such instruments are frequently drawn by business men and others who are short of funds and give out checks in advance, hoping to meet them when presented on their due date. It is a practice to be condemned, and such checks often are put through by the holders in the hope that they will escape the scrutiny of the bank clerks.

Neither should a check be paid that is "stale"—that is to say, long past in its date. Just how old a check must be to be classed as stale has never been settled in law, but a check two or three months old would be open to inquiry, and caution would suggest that the maker be asked to authorize its payment, although the stale check is not a banking problem and has little of the danger element in it. However, a check a year old would certainly be open to inquiry. A check without date is good ("Negotiable Instruments Law," Section 6).

Words and Figures.

The figures and the written amount must agree. Where there is a discrepancy, the words control ("Negotiable Instruments Law," Section 17), although the custom is to pay the lesser amount, or return the check

for guarantee of amount by the bank presenting the same. As a matter of fact the great bulk of bank checks are presented through the clearing house in clearing house cities, and through the mails from correspondent banks, in other places. Over the counter checks are relatively few in comparison.

Signature.

Inasmuch as the contract of the bank with the depositor is to pay his checks only when properly signed, it follows that if the signature is forged the instrument is void and never had a legal conception. And where a bank pays a forged check it cannot charge the amount to the depositor ("Negotiable Instruments Law," Section 23) Therefore, the paying teller must know the signature of every depositor in the bank, and if in doubt, turns to the signature cabinet for verification

Alteration.

The reason a bank cannot charge an altered check to a depositor in a larger sum than originally drawn is the fact that it has violated his order. His order was to pay the original sum, and unless the instrument is so carelessly drawn as to invite fraud, the burden is upon the bank.

If due care has been used in issuing the check, and it is afterward raised, the bank may charge the original amount, but no more. Therefore checks are examined also for their general appearance to detect material alterations (for the law on this point see "Negotiable Instruments Law," Sections 124-125)

Identification.

Where checks are offered by those not well known to the teller the holder must be identified. This is most safely done by requiring some one known to the teller to indorse the check, without recourse, or by word of

mouth to vouch for the identity of the party. But often checks are presented by comparative strangers, and in the effort to extend courtesy to everybody, in the hope of creating good will, many banks will take a business chance on such people. In these cases letters addressed to the holder, names on wallets, in watches, monograms, automobile license cards, military enrollment cards, etc., will often prove valuable in making the identity reasonably certain. In such cases the teller can use a great deal of business psychology to good effect, his knowledge of human nature standing him in good stead.

If the check is drawn on another bank, the foregoing comment applies (except as to signature), and only the above-named features need be given attention—with the exception that the check must of course be indorsed. But if the check is drawn on the teller's own bank, there are two additional features to be inquired into. The first is

Is the Balance Sufficient?

This can only be discovered by communicating with the bookkeeper. Some men are always good for their checks, while others are always under suspicion. In some cases the teller never thinks of inquiring as to the balance, in others he would assume the risk of overpayment (overdrafts) if he did not follow the balance of the depositor constantly. Therefore all doubtful checks are referred to the bookkeepers before being paid.

Assuming the balance to be sufficient, one thing remains.

Stop Payment

Under the rule that a depositor has the right to draw as many checks as his needs require, in sums large or small, he has the right to rescind his orders at any time before they are actually executed. Therefore, many stop

payments are filed with banks and are the bane of the bank clerk's life, for to dishonor them invites trouble. Checks are lost or stolen, business deals get into com-

_____ 10/1 1921

To IRVING NATIONAL BANK
WOOLWORTH BUILDING, NEW YORK

Please stop payment on our { Check
Draft
Note

dated 9/29/21 numbered 2875

to the order of Smith & Brown

for \$ 152.⁵⁰ ... which has not been charged against our
account on the statement for any previous month.

If duplicate of above is presented, please pay and charge
to our account.

We understand that you will use your best effort to avoid payment of the
item mentioned above, but agree not hold you liable on account of payment contrary
to this request should it be occasioned through inadvertence or accident.

Exact Title of Account John Doe & Co.

Address 150 Broadway, N.Y.C.

Signature John Doe & Co.


This request to bear only signature authorized on checks. If original be
returned please cancel this order.

In issuing duplicate check please write **DUPLICATE** across face of check over
authorized signature.

FORM 10 —Stop-payment notice

plications after checks are issued, and the first thought in the mind of many depositors, when anything goes wrong financially, is to stop payment on the check

Frequently banks are called on the telephone and asked to stop payment on a check, but inasmuch as the law requires the countermand to be in writing and good practice sanctions it, banks do not honor such requests.

IRVING NATIONAL BANK	
WOOLWORTH BUILDING, NEW YORK	
	
_____ 10/1 19__	
<u>John Garcia</u>	
<u>150 B'way N.Y.</u>	
We have your request of the <u>1</u> inst,	
to stop payment on	{ Check Note No <u>2875</u> for Draft
\$ <u>150.00</u> and same will have our careful attention	
Examination of our records shows that the above mentioned item has not been charged against your account for the current month, and is not among the cancelled vouchers in our possession at this date	
Kindly examine cancelled vouchers which have been returned to you, and, if not found, fill out the enclosed form and return in order that our records may be complete	
Yours truly,	
E D JUNIOR,	
Cashier	

FORM 11 — Acknowledgment of stop-payment notice

A telegraphic stop payment would be binding, since it is a written request

The following incident well illustrates the law and the practice in regard to stop payments. A party was

playing poker in a country grocery store one Sunday night. One of the players lost what he had with him and asked the storekeeper to cash a couple of checks for

New York,	<u>10/29</u>	19 <u>21</u>
IRVING NATIONAL BANK		
WOOLWORTH BUILDING, NEW YORK		
Please cancel order to stop payment on our <u>CN</u>		
dated	<u>9/27/21</u>	numbered <u>2875</u>
to the order of	<u>Smith & Brown</u>	
for \$	<u>152⁵⁰</u>	
<u>John Doe & Co</u>		
<u>150 Broadway New York</u>		
This request to bear only signature authorized on checks		

FORM 12—Cancellation of stop-payment notice

him. These amounts he also lost. The game broke up and the players went home, the loser to a troubled sleep. Towards morning he got up and drove into town and

called the bank cashier out of bed and asked him to stop payment on the checks he had given the storekeeper, only to find the storekeeper had "beaten him to it" and offered them for deposit. Thereupon he hired a lawyer and sat on the front steps of the bank until the first clerk appeared, and served a written notice—which was good *You can make deposits only at the banking room of a bank, and your stop payments must be lodged there before the checks are presented to be effective*

In another case a saloon keeper gave an order for a barrel of whiskey. He drew his check for \$48 and gave it to the agent, who booked his order for two barrels (this before the days of prohibition). This incensed the saloon keeper and he canceled the order and stopped payment on the check. By some oversight the bank paid the check, which still further incensed the drawer, and he demanded his money—and got it. The bank thereupon took over his order, paid the taxes, and held the whiskey as a "liquid asset" until it could find a dealer willing to take it off its hands—which was a more difficult feat than would be the case today.

Some banks have proper forms for stop payments, and agree to use only reasonable care to catch the items, and are to be held harmless if the check is paid over the stop order; but it is questionable if this would hold good in court.

When these stop payments are sent in, notice is given the bookkeepers as well as the tellers, so that the check may be caught in one department if the other fails.

How Banks Watch Stop Payments.

One great advantage of checks over money lies in the fact that a check which is stolen or lost may be recovered by the simple expedient of stopping payment at the bank. That device has given rise to a trade within the banking business. In the large banks of New York, for example, the trail of lost checks engages the energies of many hunters.

Sportsmanship is combined with business, and the official who pursues the vagrant scraps of paper has all the zest of the tracker of game in the wilderness. Big game, in fact, is often the quarry sought, and the failure to read the signs aright sometimes is serious enough.

This great volume makes the work of the check hunter important. At the Bank of Manhattan Company, for instance, one person, an assistant teller, is the especially designated watchman of the "stop-payment" check territory. In other days, when gold and banknotes were the medium of exchange, the loss of money was apt to be final. If a man lost a hundred-dollar bill he comforted himself with what philosophy he possessed. He had no hope of retrieving what had disappeared. Or if he made a payment and then found that he had been deceived, he had no redress except through the tedious process of the courts. With checks the matter is simplified. A stop-payment order is sent to the bank and the lost is ordinarily soon found.

The means used are interesting. Every morning the tellers are given a list of the stop-payment orders for the day. Each man and woman memorizes all the names and numbers. In addition to this the assistant teller whose function it is to catch these checks becomes active. "Red flags" are set up. Every bookkeeper, every teller, every clerk who may see the vagrant check is warned. Large sheets of paper with colored printing at the top are distributed. The young men and women who bang away on numerous machines may become ever so absorbed, but they find it difficult to pass the danger sign. A veritable semaphore system has been built up. It is as easy for a trained engineman to carry his train past a red flag as it is for a bank teller to cash a stop-payment check. And when one of the lost is found the hunter is surrounded with a halo of excitement. I saw the expression of such an official who had just captured a stop-payment check for a particularly large amount. The hunter who had toppled his first grizzly or the fisherman who had landed a tarpon could have had no more enthusiasm.

Causes of Stop Orders.

The causes of this stop-order system are in themselves significant. The first and the simplest cause is the mere loss of the check. The stop order is issued almost automatically. According to one of the bank officials charged with the responsibility for supervision of this situation the maker of the check must issue the stop order. The person to whom the check has been made may give warning of the

loss That is all The bank is not compelled to accept the instructions of any one except the maker The official continued

"Other causes are important also The lost checks are ordinarily small Sometimes, however, very large checks—I mentioned one for a large amount which was caught this morning—are ordered stopped The reasons in such cases are numerous Breach of contract, repudiation of contract, a man repenting of his bargain, explain some of the orders The bank has no authority to refuse to obey the stop order except in certain rare cases It does not enjoy being an instrument through which a contract may be repudiated We feel, in fact, that repudiation is one of the serious causes of trouble at the present time

"But I would not be understood as implying that breaches of contract or repudiation of contract are frequent occurrences in this quarter Take the Stock Exchange for example I know of no place where a higher standard of personal honor prevails Contracts are made not in writing but by the spoken word On the floor of the Exchange the simple nod of the head is at all times as good as a signed bond In the high-grade banks the repudiation of contracts as it is revealed in stop-payment orders always brings scrutiny to the account If a man were found to be consistently committing breaches of contract, we should decide that his account ought to be removed We would feel that he was not the sort of man we cared to do business with But that seldom occurs with us

"The stoppages come chiefly where contracts are involved because of technical rather than moral questions which are in issue Checks ought to be cashed immediately 'Due diligence' is required and whenever an old check—we call it a stale check—is presented for payment the matter is investigated This is done quickly Often customers have had their accounts examined before they knew that any question had occurred Then again the bank teller, like the politician, has a long memory He must have a sound memory as a part of his equipment

When I was younger I served as a teller I knew then and I still know thousands of individuals I connect the customer with his business or with the place where I first saw him Further, all good tellers have keen memories for signatures Any experienced teller can describe peculiar characteristics of the signatures of the customers whose checks come through his window Some tellers know thousands of signatures in this way That memory is another of the safeguards thrown around the checking system

"I have indicated some of the methods used to locate and stop the payments on checks which the maker desires to have refused. A search, high and low, is always made. His account is examined and all his vouchers are listed and immediately the warning is given. When the word comes I always stop whatever I am doing and set the machinery in motion. For months now we have not failed to catch every such check. I knock on wood when I say it for sometimes to fail would be serious. I don't know what would have happened had we missed that check this morning. Happily we found it, and still better, such episodes are not frequent."¹

Payment Against Uncollected Funds.

There is one other matter to be given attention in paying checks, and while this more particularly applies to the bookkeeper, it nevertheless pertains to the payment of the check and naturally follows the paying teller's work, namely, payment against uncollected funds.

It is obvious that if a bank in Albany, N. Y., receives a check on deposit, drawn on a bank in Boston, let us say, today, and allows the depositor to draw against it today, it is advancing him the amount until it receives payment from Boston, and that without interest. But if it holds back payment on the amount of the check for three days, it will have returns from Boston, and will pay out only funds received by it from the Boston bank.

The problem of uncollected funds is one of the real problems of the bank. Most people regard a check as cash and as soon as it is deposited treat it as a cash deposit, and expect the bank to pay against it. That this is fallacious is easily seen. In the chapter on "Exchange" (Chapter X) will be found a discussion on exchange, reserves and how they are created. Suffice to say here that until the bank has reduced a check

¹ From the *New York Times*

to cash in the vault or a credit with its city correspondent or the Federal reserve bank, it is merely an order to pay money. It is not and never can be anything else. And to ask the bank to pay in cash, or by drawing on its correspondent, thus reducing its balance with it, is to ask for an advance of the amount until the actual funds are received or credited. This no well-managed bank will do willingly, because of the cost in loss of interest and the danger that lies in advancing upon checks that may not be paid. To provide against this the bookkeepers are instructed to watch the accounts, and detect this practice and prevent it. But only by a close analysis of each deposit and of what it consists can the bank work safely. Thus we may indicate on the ledger alongside a deposit "3"—meaning hold back payment for three days (see "Transits," Chapter IX, for further treatment).

The danger in paying against uncollected funds may be seen from an actual example. Bank A had a check for \$12,000 drawn on bank B. The balance in bank B consisted of cash \$4,000 and two checks, one for \$7,000 and the other for \$8,000, making \$19,000 in all. It would be three days before the returns would come in from the two checks. On the morning of the third day bank B paid the \$12,000, and immediately afterward received notice that the two checks were being returned "short." It therefore found itself with a shortage of \$8,000 on this account, which was not made good for several weeks. This is typical of many such happenings where the uncollected funds are not watched carefully, and even then errors and delays will occur. The proper course in such a case would have been to ask for advice by wire of the fate of the checks, or to have called up the bank drawn on before making payment against the two checks.

Canceling Paid Checks.

After the check has been scrutinized and paid, it is "spindle cut,"¹ to prevent further negotiation, when it is listed on the teller's sheet and in due course distributed to the department to which it belongs. In this classification the paying teller follows the same arrangement as the receiving teller, and checks from his department go through exactly the same channels as those from the receiving teller. The latter gives credit for the checks received, while the former gives cash, or its equivalent, and checks from both sources must be turned into reserve at the earliest possible moment. Checks that are paid through the exchanges or the mails are settled by bank draft or otherwise, as discussed under "Clearing Houses," and all checks before filing are cut with the word "paid" and the date, thus

P A I D
+ 7 : 14 : 21


FORM 13—Cancellation for checks paid—all checks are "cut" before filing

Pay Rolls

Large banks make up pay rolls in large amounts, and all banks do this to a greater or less degree, the volume being greatest in manufacturing centers where labor is paid off weekly in cash. A requisition is made upon proper form, showing the amount of currency and silver of the various denominations required. This is usually sent to the bank a day or more ahead of time, to avoid delay and congestion at the window. In some banks the money is placed in the pay envelopes at the bank, as a courtesy to the depositor, but this entails a

¹ Only checks on the teller's own bank are spindle cut. Others may be stamped "first teller."

vast amount of clerical work that does not properly belong in the bank

IRVING NATIONAL BANK		
NEW YORK		
		
DEPOSITOR		
Name <u>John Doe & Co</u>		
PAY ROLL <i>10/2</i>		
	DOLLARS	CENTS
Ones in packages of \$25 & \$50	200	
Fives " " " 100 & 250	550	
Tens " " " 100 & 500	500	
Twenties " " 500 & 1000	80	
Large		
Pennies 25 & 50c Rolls	250	
Nickels \$1 & \$2 "	5	
Dimes 5 "	10	
Quarters 5 & 10 "	30	
Halves 5 & 10 "	10	
TOTAL	1387	50

FORM 14—Requisition for pay roll

Currency Shipments.

The large city banks ship to their correspondents large amounts of currency, and in return receive from

them large amounts, the inflow and outflow depending upon the season. The amount called for is charged to the depositor by proper ticket, and the money securely wrapped and dispatched by express or registered mail insured. The messenger usually attends to the shipping of valuables and the fact of actual shipment is verified, in some banks by affidavit.

Clearing House Settlements.

Formerly the custom of clearing house banks in making settlements between members was by money or clearing house certificates, as discussed under "Clearing Houses." The paying teller was responsible for obtaining payment of the amount due his bank and for paying the amount due from his bank, but under the régime of the Federal reserve bank, this no longer obtains, and these balances are adjusted by debits and credits on the books of the Federal reserve bank. If the bank has a credit balance (an amount due from other banks to it) the bank's balance in the Federal reserve bank is increased, and if the balance is a debit, it is reduced, the same as if the bank were to make a deposit in money or draw its check on the Federal reserve bank.

In cities where these adjustments cannot be made through the Federal reserve bank, settlements are made by the old method, namely, clearing house certificates and cash, or by bank drafts upon the city correspondents.

The Paying Teller's Day.

The paying teller's day begins with his cash supply taken from the current cash vault and arranged by denominations in the cash drawers. Some is loose but most of the cash is in packages. Silver is carried in trays, wrapped, while the loose change is generally placed in the automatic cashier, which delivers coins of various denominations by pressing certain keys, and is both accurate

and rapid. Thus if 98 cents be desired, the pressure upon one key delivers three quarters, two dimes and three pennies. To the amount at the beginning of the day the teller adds the receipts turned over to him from various sources, deducts the cash payments, and the balance represents the cash on hand at the close of the day.

Having started the day with a certain amount of cash, it follows that the paying teller will charge himself with all cash received and credit himself with all cash paid out, and the difference is the balance on hand at the close of the day; and the cash itself must agree with this proof.

Overs and Shorts.

Even the most careful tellers make mistakes, and it is but human that they should. In the many thousands of items handled during a day, errors are bound to creep in that cannot be detected. Where the proof is made by the block system in the receiving cage, the chance of error is greatly eliminated, but in the paying cage, once an error is made in cashing a check or in making up a pay roll, it is quite impossible at times to locate the trouble. Where such is the case, the work is carefully checked back until certain that it is beyond recall, and it is held as an "over" or a "short" in the "teller's difference account." The proof sheets are kept showing the discrepancy, and where, for instance, a deposit is made without a ticket, and an overage exists, it will sooner or later turn up in balancing the account, and proper credit be given. If it is an overpayment, it is, as has well been said, "a fight with conscience" on the part of the one receiving the overpayment, and upon him rests the burden of restoring the amount. If the amount is underpaid, he will, if ordinarily careful, quickly discover the fact and report. In a few banks the tellers are

penalized for errors, while in others it is taken as part of the day's work and reported to the proper officer, and book adjustment is made by proper ticket.

Pay Roll and Petty Expenses.

The pay roll of the bank is generally made up by the paying teller, and where the employees number two or three thousand, as in a few instances, this work is sufficient to occupy the attention of a clerk all the time. He also has charge of the petty cash fund and pays the incidental expenses of the bank. The postage and revenue stamps of the bank are also put through the petty cashier.

A roster of the bank is kept and the amount of compensation due each employee is computed from the registration records. The pay roll is sent to the petty cashier a day or two before it is due. Check to his order is drawn to cover, and after cashing, the money is placed in envelopes and distributed at the appointed time. It is the usual custom not to allow the clerks to know the salaries of others for obvious reasons, and receipts are taken at each disbursement from the various recipients. Some banks have a pay roll book which is signed by the employee, who receipts for "salary to date," without listing the amount. In small banks the money is distributed in envelopes with no formality whatsoever. The usual rule is to pay on the first and fifteenth of the month.

Certifications.

It is the paying teller's duty to certify checks, which is in substance paying them, for the bank by such certification turns an *order on a bank into a promise by a bank*, ("Negotiable Instruments Law," Section 187). Certification consists in stamping the check across the face "Certified" or "Accepted" with the date and

signature of the bank's officer or teller (Tellers are not regarded as officers, although next in line for official title) When this is done, the account of the maker of the check immediately is charged with the amount and "certified check account" is credited Therefore the maker of the check is discharged and the bank assumes the obligation and must pay it

There is a difference, however, as to who has the check certified If the holder has it done, the maker is released, for the holder had his option of taking cash or the bank's promise, and having accepted the latter cannot come back and claim reimbursement from the maker He must look to the bank ("Negotiable Instruments Law," Section 188) But if the maker has it certified as is done in many cases, the holder has no such option and can claim reimbursement from the maker in case the bank fails or for other reason the check is not paid upon presentation Certified checks are used in Wall Street transactions in large numbers and also in real estate transfers, being treated exactly the same as money

Checks that are certified are recorded in a certified check register by maker, number, drawee, amount, date, etc., and the total of the outstanding checks must equal the amount shown on the general ledger As they are paid they are so indicated in the register, so that the actual outstanding checks, and for whom certified, may be known at all times

Other Certifications

Where a note is made payable at a bank, it is equivalent to an order on the bank to pay the amount at the time stated ("Negotiable Instruments Law," Section 87) In many cases such notes are presented at the note teller's window and are certified and sent through the clearing house the next day, the same as a check would be.

The act of certifying a check is equivalent to paying it and the same steps are necessary before certification as before paying, namely, examination as to date, words and figures, signature, indorsement, sufficient funds and stop orders

Where certifications run into large figures and the items certified are many, a certification department is operated. This department has a list of all active accounts that certify daily, such as of stock brokers who use certified checks very largely. The clerk in charge has a list of the balances at the beginning of the day, the credits as they come through, and the charges, so that he knows the limit of his certifying power all the time. Where the balance is not known, the bookkeeper is communicated with and the balance ascertained.

In the large banks the one presenting a check for certification is given a ticket which must be presented before the check is delivered. This prevents these instruments from falling into the wrong hands and avoids congestion of the line, since certification of a check takes considerably longer than cash payment. The number on the ticket corresponds with the certification number, thus identifying the check and the person to whom it belongs. Certified checks that are outstanding for a long period are followed up and the reason for the long delay inquired into.

The obligation of the bank on a certified check is precisely the same as on its bank notes—it is its promise to pay. The certified check, however, has no security pledged for its payment such as the bank notes have, but the entire assets of the bank are the safeguard. A certified check is therefore, "as good as the bank."

When lost or stolen or destroyed, certified checks are replaced only upon the filing of a bond of indemnity against the double payment which might accrue should

the original turn up in the hands of a *bona fide* holder for value. If a certified check is not used, it should be re-deposited to the drawer's account and automatically it will be canceled from the bank's records. They should never be destroyed in the same manner as are unused uncertified checks.

Checks of Deceased Depositors

It is a rule of law that the death of the maker of a check revokes his orders, and the bank cannot pay after notice of death. What is notice will, of course, depend upon circumstances. But until the bank has knowledge of the death, it may pay checks as presented.

Inasmuch as the law never leaves a man without representation, as soon as he dies some one automatically steps in and acts for him. If he leaves a will and names an *executor*, he acts, if no will is made, an *administrator* is named by the court. The right to draw the moneys on deposit then goes to the legal representative, but before he may act, he must assure the bank that he has that right, by producing his certificate of appointment, which is kept in the bank files.

Corporation Checks

In the case of corporations, the teller has on file the certificate showing who is qualified to act and sees to it that checks are signed in accordance with these instructions.

The proper way to sign corporation checks is

The X Y Z Co.,
By James Johnson, Treas

For a deceased person

The Estate of Elizabeth Smith,
William Smith, Exr (or Adm.)

Legal Tender.

The term "legal tender" is often used in business circles and although not clear to many is in reality

exceedingly simple *It is that form of money which a creditor is obliged to accept in payment of a debt* The use of this kind of money is more or less common, and tellers are frequently asked for the amount in this form. The object may be best seen by a practical illustration A contracts with B to buy B's house on agreed terms, at a certain time Subsequently, B gets a better offer and when the time arrives refuses to deliver. A offers his check B need not take it A has it certified Still B need not take it A offers various kinds of money and still B need not accept; but if A offers *legal tender*, B must fulfill his agreement Again A holds a mortgage on B's house If A can get B in default of interest, he can foreclose and buy it, it may be, cheap. On the day the interest is due, if B tenders the amount in legal tender, A must accept, no matter what excuses he may bring forward, and if the mortgage is due, and legal tender offered and refused, interest stops at once. The following are legal tender

Gold in any amount,
Silver dollars in any amount,
Gold certificates in any amount
Greenbacks in any amount,
Treasury notes of 1890,
Halves and quarters up to \$10 in one payment,
Nickels and pennies up to 25 cents

Partnership Accounts.

In partnership accounts, either partner has the right to sign checks, or to make notes and contracts, for the firm account, but since many partnerships have an agreement that both must sign, the bank must satisfy itself that the agreement is followed. Thus it does by requiring a copy of the partnership papers, or a certificate of the facts therein contained

CHAPTER VI

PROTEST

The term "protest" is used to describe the steps taken to fasten legally the responsibility of parties to negotiable instruments that have been dishonored. A "notice of protest" is a formal notice by a notary attesting the fact that an instrument has been properly presented for payment or for acceptance and dishonored. Whenever such instruments are dishonored, they are returned to the source from whence they came with such notice attached, and a protest fee, running from 75 cents up to \$2, is collected or charged back from one party thereto to another until it reaches the original party. This fee goes to the notary, who is frequently a bank officer or clerk, or in many cases to the bank which employs him. The reason for protest, legal and practical, will now be inquired into, and the basis for the practice will be found in the "Negotiable Instruments Law."

The Reasons for Protest

We have seen that when an instrument is indorsed the indorser warrants among other things "That on due presentment, it shall be accepted or paid, or both, as the case may be, according to its tenor, and that if it be dishonored and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it" ("Negotiable Instruments Law," Section 66). It is further provided that "Except as herein otherwise provided, when a negotiable instrument has been dishonored by non-acceptance or non-payment,

notice of dishonor must be given to the drawer and to each indorser, *and any drawer or indorser to whom such notice is not given is discharged*" ("Negotiable Instruments Law," Section 89)

Therefore the reason, in brief, for protest is to hold the indorsers, for if the proper legal steps are not taken they are discharged of their liability.

United States of America }
State of New York } ss
City and County of New York }

On the *10th* day of *October* in the year of our Lord one thousand nine hundred *twenty one* at the request of Irving Trust Company I, AL. BERT BIELER, Notary Public in and for the State of New York, duly admitted and sworn, dwelling in the County of New York, did present the original PROMISSORY NOTE, which is hereto annexed to the

First Nat Bank New York

and then and there demanded payment thereof, which was refused

Whereupon, I, the said Notary, at the requests aforesaid, did PROTEST, and by these Presents do publicly and solemnly PROTEST as well against the maker and endorser of the said Note, as against all others whom it doth or may concern, for exchange, re-exchange and all costs, damages, and interest already incurred and to be hereafter incurred, for want of Payment of said Note

Witness mine and Protested, in the County of New York, aforesaid
in the presence of

Richard Roe, witness.
IN TESTIMONIUM VERITATIS

A. B. Bieler

John Doe
Notary Public, N. Y. County
Certificate filed in New York County

FORM 15—Certificate of protest

The practical reason is that if the indorsers have prompt notice of the non-payment of an instrument, they can immediately proceed to protect themselves. For instance A, a dealer in New York, holds a promissory note of B in Ohio, for merchandise sold and delivered. They continue to trade together, and the note falls due.

It is dishonored. If the fact is immediately conveyed to A, he can at once take measures to protect himself. He may have other goods ready for shipment that may be withheld. He may have security or guarantees, in one form or another, that may be enforced, but if he is ignorant of the fate of the note, he is dealing in the dark with one who may cause a further loss to him.

A further legal reason for protest is that an instrument properly protested needs no other proof in a court of law than the notary's certificate and records to prove that presentment was properly made.

To treat the subject of protest properly, a review of the Negotiable Instruments Law covering presentment and notice of dishonor would be necessary, and the student is referred to the law for a further study of the subject.¹

Protest is such an old custom and so thoroughly a part of our commercial life that the process should be known to all who transact business, particularly bankers. It is an integral part of the law merchant and a vital part of banking practice.

Rules for Protest.

Briefly summarized, the rules regarding presentment, protest and notice of dishonor are as follows:

1. *Foreign bills*—Instruments drawn in one country or state and payable in another are the only ones that *must* be protested. Others *may* be protested and as a rule all dishonored instruments are protested, as a matter of precaution and record. In many cases banks do not protest checks for small sums, the amount depending upon the practice of the bank. On many collection

¹ See Liability of Parties, Presentment for Payment, Notice of Dishonor, Sections 60-118 "Negotiable Instruments Law."

letters the instructions are to protest all unpaid checks over a certain amount, such as \$10.

2 Where the law requires protest, failure to do so discharges the drawer and indorsers.

3 Protest is usually made by a notary, but may be made by a private citizen attested by two witnesses

4 The form of notice of protest is usually printed, and no particular form is necessary, but the notice must

(a) Be attached to the instrument, or contain a copy of it

• (b) It must be "under the hand and seal" of the notary.

(c) The time and place of presentment must be specified

(d) It must state that presentment was made

(e) It must state the reason for protesting the instrument.

(f) It must state that demand was made for payment and the answer thereto

(g) If the drawee or acceptor could not be found, the fact must be stated

Unless the certificate is false, a notice of protest meeting the above requirements will be accepted as evidence throughout the world

5 Protest must be made on the day the instrument falls due When the notary makes his demand, he makes a note thereof on the instrument or in his records, or both, and this is called "noting" The drawing of the papers may be done later, but dated as of the date of protest

6 If the instrument has been lost, protest may be made on a copy thereof.

Notice of Dishonor

We have seen that it is necessary to present properly an instrument for acceptance or payment, and to give

notice of non-payment to the indorsers if they are to be held liable. Failure to give notice relieves them of their contract. To this end, we have the *notice of dishonor*, which is sent to the several parties and follows the act of protest on the part of the notary. The steps necessary to hold the party liable are (1) Proper presentment, (2) notice that payment has been refused by the party who should make it, and (3) that the holder looks to him for payment.

How Notices of Protest Should be Sent.

Notices of protest are usually sent by mail. Where a party has added an address to his signature, notice

New York City <u>Oct 3</u>	
Please take notice that a <u>note</u>	
made by <u>John Doe & Co</u>	
for <u>\$1000</u>	dated <u>July 2</u>
payable at <u>Seaboard Nat Bank</u>	
indorsed by you is protested for non payment and that the holders look to you for payment thereof	
To <u>Richard Roe & Co</u>	
<u>5 William St N.Y.</u>	
AL. BERT BIELER, Notary Public New York County Certificate filed in New York County	

FORM 16 — Notice of protest

should be sent to that address. Where no address is given, it may be sent to the post office nearest his place of residence, or to the post office where he is accustomed to receive his mail. If he lives in one place and has a place of business in another, it may be sent to either. If he is sojourning in another place, it may be sent there.

Reasonable effort must be made to ascertain the address of the party, but what is reasonable diligence in

ascertaining the address is a matter dependent upon circumstances. Carelessness in this matter may make the notice inoperative. However, a notice deposited in a letter box, mail chute, branch post office or other receptacle under the control of the Post Office will be sufficient.

Time of Notice.

The *time* when these notices are sent out is vitally important, and the law must be followed if the liability of indorsers is not to be excused. If the party giving and the party receiving the notice live in the same place, the notice must reach the latter before the close of business on the day following the protest. It is usually expressed as "within twenty-four hours." Business hours are the usual hours that obtain in the community. If the notice is given at the residence, it must be given before the usual hours of rest on the day following. If sent by mail it must be deposited in the mail in time to reach the party in the usual course on the day following.

Where the parties reside in different places, the notice must be deposited in the post office in time to go by mail the day following the day of dishonor. If there be no mail at a convenient hour on that day, by the next mail thereafter.

The holder is bound to notify only his immediate indorser, and this indorser has the same length of time from the receipt of his notice to notify his immediate indorser, thus giving each party one day or more, as the rules allow, to notify their predecessors. Ordinarily, in making protest, banks send all notices to the last indorser, with stamps attached, and a notice for each one. The bank retains its copy and forwards the others to its indorser, who in turn notifies his indorser, and so on until all are notified.

Presentment and Protest May Be Waived

Proper presentment, protest and notice of dishonor may be and often are waived, many banks having such waiver printed on the back of their notes. In such cases the foregoing rules do not apply, although protest is often made on promissory notes and bills of exchange which contain an express waiver. It is the safe and practical way. There are certain cases where protest and notice of dishonor are unnecessary, but to discuss them here would confuse the student, and for that reason the above rules are given without further discussion, or qualification. (The student is strongly advised to study Sections 60-118 of the "Negotiable Instruments Law" for a clear understanding of these essential features of banking practice.)

CHAPTER VII

BANK CHECKS

The bank check is in many respects the most wonderful of all the instruments used in business circles. When it is considered that checks are the medium for settlements made in business matters running into the millions in number daily, and involving billions of dollars, then utility becomes manifest. If a debt is due, one to another, near or remote, all that is necessary is the drawing of a bank check and mailing the same, and the banking machinery takes care of its payment.

The bank check rises to the height of its usefulness as a conserver of money, for it eliminates the use of money in fully 90 per cent of the total volume of business. In the course of 67 years there has passed through the New York Clearing House the inconceivable sum of *three and a half trillion dollars* in checks, which have been settled with but two hundred and seven billion dollars—in comparison a modest sum, and now by using the Federal reserve banks as a medium of settlement for these balances, the use of money is entirely eliminated. And New York clearances represent but a small part of the total business of the United States.

The use of the bank check has grown in recent years by leaps and bounds, due to the fact that banks are to be found everywhere, and as these banks have encouraged the opening of checking accounts for household and business purposes, even the man and the woman of moderate income now has a checking account, through which payment is made for the current expenses of life.

In fact, the bank check may now be said to be our national currency, expanding and contracting in number and amount as the demands of business and domestic life require. When business is brisk, they multiply in number and the amount involved increases, and when slack times come, they automatically reduce themselves, so that the volume of check clearings is a very reliable barometer of business conditions and is so looked upon by economists and bankers who follow fundamental conditions. Therefore, we do well to pay homage to this simple yet highly efficient servant of business.

Checks Displace Money.

Checks are the modern substitute for money. Currency is good enough for the small affairs of life, for the incidentals of the day. Larger matters tend more and more to be handled only by the aid of these symbols of wealth. The substance is almost never seen. This represents a revolution in business, another American revolution, for the United States is the country where par excellence the checking system prevails. The changes that have been involved in this revolution are far-reaching. Gold is almost never visible. Its chief present use, apparently, is as gifts for children and servants. Certainly nobody east of the Rocky Mountains ever carries it as money.

To carry gold in a purse is as obsolete as mutton-chop side whiskers. It is not done any longer. Bank notes are almost as bad. They are so dirty now that few want to handle them. What with the scarcity of paper and the issuance of Liberty Bonds, the banknote presses have apparently ceased working. The result is that the old, frayed, germ-harboring tokens of wealth are no longer popular. Checks, new and clean, are the substitute. Consequently, checks are in vogue as never before. During an average day one of the major Wall Street banks will handle a hundred million dollars, and more, in this personal variety of currency.

Checks represent money. The checking system makes it convenient to transact business with a relatively small sum of actual coin and currency. Comparatively speaking, there is very little money in the country, and in the world, for that matter. In 1918 the total amount of gold and silver and smaller coin in the United States Treasury was only approximately \$300,000,000. That is

an insignificant sum when contrasted with the total volume of business or the total wealth of the country. More than one private fortune is estimated to be larger. If the owner of the largest fortune were to attempt to convert his wealth into gold dollars, provided the Government did not intervene, he might easily absorb all the gold coin in the country.

Growth of the Check System.

The checking system is the device which renders possible the enormous volume of business done without the sight of money. The figures of the New York Clearing House show how small a rôle real money now plays. Last year more than two hundred and fifty billion dollars in checks were passed through the Clearing House. This is only a fraction of the total amount of the checks used in the country. There are 154 other clearing houses in the country. Even these do not take the full measure of the use of checks. For checks which are cashed directly in the banks at which they are payable are naturally not included in clearing house figures. In New York alone during a year the volume of checks reaches a figure which is perhaps a thousand times as large as the entire sum of gold in the country.

This is a growth of years. It is peculiarly an American phenomenon. In the United States a very large proportion of the population keeps bank accounts and a much larger number uses checks. In many European countries, on the other hand, the keeping of a bank account is the privilege of the well-to-do. Everyone who has had relations with European banks knows the long formality of getting a check cashed. It is as elaborate at times as being presented to royalty. It matters little that the customer may be in the bank which is the custodian of his own funds. He must pass through the identification ritual. That is not to be taken lightly.

In the United States more rapid methods have been developed. Much of this has come during the last twenty-five years. Bank clearances show the trend. The change between 1865 and 1895 was not very great, but the growth since the free-silver campaign has been a veritable revolution. In 1865, for example, twenty-six billion dollars' worth of checks passed through the New York Clearing House. In 1895 the total was only twenty-eight billions. Higher figures had been attained in the early eighties, but, on the whole, the growth has been steady. After 1897, however, business boomed, and with the new prosperity came the era of checking. With an assured progress, despite ups and downs which measured the prosperity or

the depression of passing years, clearances reached higher figures. In 1906 a record was made. This was almost equaled in 1910, when once more the hundred-billion-dollar mark was topped by the New York banks. Then came a slump which lasted through 1915. The next year witnessed the greatest growth, and every year since has marked an advance not less astounding.

The Problem of Money.

What this signifies is perhaps not entirely clear. The sum of business has been vastly enlarged. The value of money has fallen. New price levels have been established. A new medium of exchange has been more firmly entrenched.

The new system has brought many minor problems in its train. When money was first used the great difficulty was to prevent the debasing and the clipping of the metal. When an ingenious inventor discovered the way to make serrate edges on gold and silver, clipping the edges of coin went out of fashion. Scientists next devoted much study to means of preventing banknotes and other paper money from being imitated. Even now the Government maintains an extensive staff to combat counterfeiting. The same problem has come up in the use of checks and machines have been invented to prevent the alteration of figures written on these scraps of paper.

Other problems arose from the need to standardize money. This has been done by making its issuance a Government monopoly. The issuance of checks, however, obviously cannot become a monopoly without destroying the effectiveness of the system. Accordingly the solution must be sought in other directions. But the difficulties are real. All banknotes in this country have the same dimensions. This makes for convenience. Checks, on the other hand, vary greatly. Many banks supply check forms of different dimensions to their customers. The detailed work of handling them is thereby complicated. Further confusion is contributed by the very diverse forms used by different banks.

One of the other serious difficulties has centered in the trouble often experienced in getting checks cashed. Large concerns which would have preferred to pay their employees by check have been deterred in other years by the knowledge that the saloon was the only place available for many workmen. To cash a check in a saloon meant the purchase of one drink always, and often that led to many other drinks and the squandering of wages. Now that the saloons survive only as clandestine enterprises, even that recourse has been lost.

Until places where men and women without bank accounts can cash their checks easily are established, a handicap on the development of the checking system will exist ¹

Checks Transfer Rights

Ordinarily a check is looked upon as an order to pay money, and this it is; but in the great majority of cases, the desire of the drawer of the check is not to have it cashed by himself or anyone else, but to transfer the right he had to a certain portion of the bank's deposits to another.

While this chapter was being written a friend of mine came into the bank. I owed him \$75 for an insurance policy, and he owed me \$40 for a set of automobile tires. We each had accounts in the same bank. He gave me a check for \$40 and I gave him my check for \$75. Now what was the effect of this transaction? I ordered the bank to transfer the right I had to \$75 of its deposits to my friend, and he ordered it to transfer \$40 of its deposits to me. And when we made our respective deposits of the checks, this is what it did.

We might have operated on the principle of the clearing house and settled the two debts with my check for \$35, but we both wanted a record of the transaction and a receipt. Had the two lived a thousand miles apart, the operation would have been the same, except that his bank would have transferred \$40 to my bank for my credit, and my bank would have transferred \$75 to his bank for his credit.

Thus we have a shifting of rights as often as checks are drawn, and in effecting these transfers, banks act as the medium for the settlement of debts near and remote.

Composition of a Bank Check.

The best definition of a bank check is "a bill of exchange, drawn on a bank and payable on demand"

¹ From the *New York Times*

Or, to make it more explicit, a check is "an unconditional written order on a bank, or banker, signed by the maker to pay a sum certain in money to a party named therein, or to his order, or to bearer on demand."

The points which a check and a bill of exchange have in common are. Both must contain an order, both call for the payment of a sum certain in money, and the parties are the same—drawer, drawee, payee. The duty to notify indorsers in case of non-payment is the same in both instruments.

They differ, in that a check is *always drawn on a bank*. Grace is never allowed on a check. The drawer of a check is not discharged by delay in presentation for payment, unless he can show he was prejudiced by the delay. A check must be drawn on funds actually in the bank. A bill of exchange need not be drawn against actual funds. Death of the drawer of a check revokes it. Not so with a bill of exchange. Certification of a check discharges the drawer, while the acceptance of a bill does not discharge the maker thereof.

To be complete, a check must be dated (although it is good if not dated) ("Negotiable Instruments Law," Section 6).

It must be signed by the maker—and a lead pencil signature has been held to be good.

The words and figures should agree.

It should not be altered in any material point, and it is sometimes held that crossing out one bank's name and inserting the name of another bank is an alteration. Some banks refuse payment on such checks.

Why a Bank Collects Its Checks.

There are several practical and legal reasons why a bank collects the checks it receives from its depositors.

(a) By law all banks are required to carry part of their

deposits "in reserve"—by which is meant in cash or in other banks subject to demand. This is sometimes called the "available fund," and is used to carry on the daily work of the bank, just as the storekeeper uses his till money and bank balance to carry on his business. The part that is not carried in cash, may be deposited with certain other banks called "reserve banks." These banks are designated by the board of directors and must be approved by the supervising authorities. These banks usually pay interest on the daily balances and so the account is earning interest for the bank all the time. Banks that are members of the Federal reserve bank must keep their reserves in the Federal reserve bank, the cash in vault being optional.¹ Therefore until the funds represented by the check are on deposit in the Federal reserve or other reserve bank, or reduced to cash, they are useless and non-productive. All banks collect their checks promptly and none are ever held over even for a day. They are reduced to a reserve balance as soon as practicable.

(b) The bank may fail before the check is presented and loss may follow. While bank failures are relatively few, there is always the danger of insolvency, and safety is a virtue for its own sake.

(c) The maker of the check may die and thus the law cancels his order.

(d) The account may not be good for the amount and the sooner the quality of the check is known the better. The rule of "first come first served" applies.

(e) The maker may stop payment, thus nullifying the check.

¹In New York, any part of a bank's reserve in excess of 4 per cent (kept in vault) may be kept in the Federal reserve bank. State banks and trust companies that are members of the Federal reserve bank must keep all their reserves in the Federal reserve bank, which reserves are the same as for National banks. Similar provisions will be found in other states.

(f) The depositor wants the use of the funds as soon as possible and unless the check is collected promptly, he may draw on the same, thus putting the bank in the position of paying against uncollected funds, and making a forced loan

(g) A check being a bill of exchange payable on demand, this demand must be made promptly if laxness is not to be charged against the bank

For these reasons a bank sends forward, the same day received, all checks but those on itself and those on banks in the same place which are to be collected the next day by messenger or through the clearing house

Kiting Checks

One of the most reprehensible business practices is what is known as "kiting checks" In dignified language, it means exchanging checks, one with another,—covering one check with another The practice can best be seen by illustration A has an account in four banks Being short of funds, he draws a check on bank 1 to order of bank 2, which he deposits in bank 2, and draws a check on bank 2 to the order of bank 1 Having created a balance in both banks, by depositing these fictitious checks, he proceeds to draw other checks on both banks for business purposes Before the check comes back to bank 1 for payment, he will "cover" it with a check on bank 3, and make good the check on bank 3 by drawing a check on bank 4 to the order of bank 3 A is getting into deep water, and *kiting is a deep-water proposition*. As long as all banks pay the checks drawn upon them, nothing happens, but as soon as any one bank holds back payment until it knows the checks have been paid at the other end, the "kite breaks."

Kiting is a suicidal operation It can be indulged for a

little time, but is sure to lead to disaster. As soon as a bank officer observes that a customer is "switching checks" between banks—drawing on one to the order of the other and *vice versa*—he begins to watch the account and analyze the deposits and checks, and soon discovers a kiting operation and stops it, although in stopping it he runs the danger of throwing the operator into bankruptcy—where he belongs.

CHAPTER VIII

THE WORK OF THE CLEARING HOUSE

In the clearing house we have the highest exemplification of the use of credit in canceling obligations, and the best example extant of the proper use of money as a medium to settle balances. The whole clearing house idea rests upon the principle that if A owes B \$10 and B owes A \$5, if A gives B \$5, both debts are settled. Or, to use a more practical example If the Irving National Bank at the end of the day finds that it holds checks on the Chase National Bank in the sum of \$500,000, and the Chase likewise finds that it holds checks against the Irving amounting to \$250,000, each might pay the other in cash the amount due, but if the Chase pays the Irving \$250,000, the handling of \$500,000 and its carriage through the streets of New York is avoided, and the same result is accomplished. Better, if the Federal reserve bank shall charge the Chase \$250,000 and credit the Irving on its books, the handling of money is avoided entirely, and herein bank credits rise to their highest usefulness

The enormousness of the business transacted through the New York Clearing House will be seen from figures submitted in the report of the manager for 1920:

The transactions for the year 1920 have been as follows

Exchanges	\$252,338,249,496 28
Balances	25,216,212,385 55
Total transactions	<hr/> \$277,554,461,881 83

The average daily transactions

Exchanges	\$830,060,031 13
Balances	82,948,067 05

Total	\$913,008,098 18
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Total transactions since organization of Clearing House (67 years)

Exchanges	\$3,570,157,362,589 60
Balances	207,269,155,417 66

Total	\$3,777,426,518,007 26
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Largest exchanges on any one day during the year

(Jan 2, 1920)	\$1,385,807,180 86
---------------	--------------------

-Largest balances on any one day during the year

(June 17, 1920)	157,020,486 37
-----------------	----------------

Largest transactions on any one day during the year

(Dec 16, 1919)	1,519,848,983 85
----------------	------------------

Smallest exchanges on any one day during the year

(April 3, 1920)	473,298,385 51
-----------------	----------------

Smallest balances on any one day during the year

(Feb 10, 1920)	49,487,370 94
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Smallest transactions on any one day during the year

(April 3, 1920)	532,174,515 96
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Largest daily transactions on record, Dec 16, 1919

Exchanges	1,384,614,055 95
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Balances	135,234,927 90
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(Clearing house year ends Sept 30)

The New York Clearing House.

Clearing houses are associations of banks subscribing to certain rules and regulations and agreeing to be bound absolutely by them. They are unincorporated and membership is voluntary. They exist in practically all large cities, and no city with eight or ten banks can afford to clear its banking transactions without the aid of this most useful medium. There are now about 199 such institutions in the United States, the New York Clearing House being the largest and best housed in every way. The New York institution consists of 55 banks and trust companies, together with the Assistant Treasurer of the United States. Twelve banks not members make their exchanges through banks which are members. Banks joining the clearing house

are assigned a number and are known by this number in banking and financial circles. Thus the Irving National Bank is known as "67" and this number will never be given to another bank. If the Irving should go out of business, the number would be left vacant.

The organization consists of officers and committees who direct the work, the executive head being the manager who is responsible for the work of the clearing house. There have been but four managers in 67 years.

The clearing house not only clears checks, but regulates interest rates, collection of exchange, and brings the banks into harmonious working arrangements for the good of all. The rules are strict and rigidly enforced.

Member banks must have capital and surplus of at least \$1,000,000, and banks having a capital and surplus of \$5,000,000 and over pay an admission fee of \$7,500, while those having less than \$5,000,000 capital and surplus pay \$5,000. The cost of operation is assessed upon the banks according to the volume of checks cleared during the year.

Non-member Banks.

Banks that do not have sufficient volume of checks to warrant membership may clear through a member upon payment of \$1,500 annually. In such cases the checks of non-member banks are treated as though they were drawn on the member bank clearing for them, thus, the North Side Bank of Brooklyn clears through the National Park Bank, and all checks received by clearing house banks and drawn on the North Side Bank are sent with the Park Bank's items.

The New York and a few other clearing houses have an examination department which examines member banks periodically, and these charges are assessed on the basis of gross assets.

The clearing house therefore performs several functions for the good of the banks and the banking world generally, as follows

(a) The daily exchange of cash items, (b) the collection of city and country checks (in some instances), (c) the promulgation of uniform practices, particularly as to interest rates; (d) mutual support in times of panic, (e) complete and thorough examinations, (f) periodical reports (in New York weekly) from member banks, showing their condition.

Up to the introduction of the Federal Reserve System, several clearing houses, notably those of Boston, Atlanta and Kansas City, collected checks on country banks for their members with the greatest of efficiency and a minimum of cost, but since the introduction of the Federal banks, this work has been taken over by them and the work of the clearing houses is now local only. In New York there is a city clearing department that collects by messenger checks drawn on non-member banks.

Through the regulation of interest paid on deposits these institutions have checked costly and unwise competition for deposits, and in their examinations (which supplement those of the public authorities) they discover and eliminate unsound methods and practices, thus keeping the banks free from adverse criticism. In their daily settlements they greatly expedite the payment of checks, to a degree impossible to measure, so that they are truly the balance wheels of banking as well as the great time, labor and money savers in the clearing of bank checks.

The Clearing Process.

A vast amount of work has been done in every bank before the gong rings and the clearing process

begins. All checks have been sorted by banks and the amount totaled on the adding machine and listed on the envelope which encloses them. Each check must bear the indorsement of the clearing bank, and unrestricted in its import. The clearing items include not only checks, but certified checks, drafts, bills of exchange,

NO 67		IRVING NATIONAL BANK				WELFORTH BUILDING, NEW YORK	
		Delivery Clerk's Statement				192	
No.	BANKS	FIRST DEBIT				RECEIVED BY	
1	Bank of N. Y. Nat'l Bk. of Am.					1	
2	Washington Comm.					2	
3	Washington & World Nat'l Bk.					3	
4	Bank of America					4	
5	Nat'l City Bk.					5	
12	Commer. National Bk.					12	
13	Atlantic National Bk.					13	
14	Nat'l Bk. of Comm.					14	
15	Genesee Bk.					15	
16	Am. Nat'l Bk.					16	
17	Nat'l Bk. of Comm.					17	
18	First Bk.					18	
19	Chas. & Phila. Nat'l Bk.					19	
20	Manhattan Nat'l Bk.					20	
21	Manhattan Bk.					21	
22	Genesee Bk.					22	
23	Am. Nat'l Bk.					23	
24	Nat'l Bk. of Comm.					24	
25	First Bk.					25	
26	Chas. & Phila. Nat'l Bk.					26	
27	Manhattan Nat'l Bk.					27	
28	Manhattan Bk.					28	
29	Genesee Bk.					29	
30	Am. Nat'l Bk.					30	
31	Nat'l Bk. of Comm.					31	
32	First Bk.					32	
33	Chas. & Phila. Nat'l Bk.					33	
34	Manhattan Nat'l Bk.					34	
35	Manhattan Bk.					35	
36	Genesee Bk.					36	
37	Am. Nat'l Bk.					37	
38	Nat'l Bk. of Comm.					38	
39	First Bk.					39	
40	Chas. & Phila. Nat'l Bk.					40	
41	Manhattan Nat'l Bk.					41	
42	Manhattan Bk.					42	
43	Genesee Bk.					43	
44	Am. Nat'l Bk.					44	
45	Nat'l Bk. of Comm.					45	
46	First Bk.					46	
47	Chas. & Phila. Nat'l Bk.					47	
48	Manhattan Nat'l Bk.					48	
49	Manhattan Bk.					49	
50	Genesee Bk.					50	
51	Am. Nat'l Bk.					51	
52	Nat'l Bk. of Comm.					52	
53	First Bk.					53	
54	Chas. & Phila. Nat'l Bk.					54	
55	Manhattan Nat'l Bk.					55	
56	Manhattan Bk.					56	
57	Genesee Bk.					57	
58	Am. Nat'l Bk.					58	
59	Nat'l Bk. of Comm.					59	
60	First Bk.					60	
61	Chas. & Phila. Nat'l Bk.					61	
62	Manhattan Nat'l Bk.					62	
63	Manhattan Bk.					63	
64	Genesee Bk.					64	
65	Am. Nat'l Bk.					65	
66	Nat'l Bk. of Comm.					66	
67	First Bk.					67	
68	Chas. & Phila. Nat'l Bk.					68	
69	Manhattan Nat'l Bk.					69	
70	Manhattan Bk.					70	
71	Genesee Bk.					71	
72	Am. Nat'l Bk.					72	
73	Nat'l Bk. of Comm.					73	
74	First Bk.					74	
75	Chas. & Phila. Nat'l Bk.					75	
76	Manhattan Nat'l Bk.					76	
77	Manhattan Bk.					77	
78	Genesee Bk.					78	
79	Am. Nat'l Bk.					79	
80	Nat'l Bk. of Comm.					80	
81	First Bk.					81	
82	Chas. & Phila. Nat'l Bk.					82	
83	Manhattan Nat'l Bk.					83	
84	Manhattan Bk.					84	
85	Genesee Bk.					85	
86	Am. Nat'l Bk.					86	
87	Nat'l Bk. of Comm.					87	
88	First Bk.					88	
89	Chas. & Phila. Nat'l Bk.					89	
90	Manhattan Nat'l Bk.					90	
91	Manhattan Bk.					91	
92	Genesee Bk.					92	
93	Am. Nat'l Bk.					93	
94	Nat'l Bk. of Comm.					94	
95	First Bk.					95	
96	Chas. & Phila. Nat'l Bk.					96	
97	Manhattan Nat'l Bk.					97	
98	Manhattan Bk.					98	
99	Genesee Bk.					99	
100	Am. Nat'l Bk.					100	

FORM 17 — Clearing house settling sheet

notes and acceptances. Items which bear restrictive or qualified indorsements, such as "for collection," for deposit," etc are not cleared unless they bear an unconditional guarantee of all preceding indorsements.

As a matter of fact the great event of the day is the clearing, and to this end all energy is bent. In the large banks the items are first sorted according to certain

groups of clearing house numbers, such as banks from 1 to 30, etc. and are thereafter assorted into the individual banks in the group

While the checks received during the day are being sorted and listed, the night mail begins to come in and, as fast as the letters are proven, the checks are sent to the racks for sorting, to be added to the day checks already having gone through the same process. It is the purpose of each bank to present all checks possible, especially the large items, at the morning clearing, and these are sorted out where a complete presentation cannot be made on account of late arrival of mail or for other causes. It must be remembered that unless the check is presented through the clearing house it cannot be collected until the next day. It may, however, be presented for certification.

The forms used in clearing house operations are simple. First, the checks are enclosed in envelopes with the amount on the outside, showing from what bank, to what bank and the total enclosures, (2) list of banks in the clearing house and the amount brought against each, (3) slip showing the amount brought by the presenting bank to the bank drawn on, one for each bank, (4) ticket showing similar entries as number 3.

Making a Clearing.

The checks ready for clearing are carried to the clearing house by messengers. In New York there are two morning clearings, one at 9 and the other at 10 o'clock. No forms are exchanged at the first clearing and no settlements are made, the intent being solely to get an early start in the banks with the bookkeeping, which has in recent years grown to tremendous proportions.

The work inside of the clearing house is performed by

as many men as the volume requires, some banks using as high as eight men at times. Each bank must have a man behind the desk assigned to it and a man on the floor with the checks to be presented. Sharp on the hour of clearing the gong rings. The clerk in front of desk "67" will deliver to the clerk from "67," sitting behind the desk, the package designed for "67," taking a receipt on the settling sheet. The small tickets are also left with the settling clerk and one is sent to the clearing house manager for his records. When the clerk has made his rounds, he will have delivered a package at each desk, obtained his receipts, and his bag is empty. The bundles of checks are then taken to the bank for payment. Each bank has presented all checks on other banks and in return has received checks on itself from the other banks. It remains to determine whether it owes the other banks (debit balance) or has a balance due it (credit balance).

The settling clerk has a list on his settling sheet of all that his bank brought to the clearing house, with a duplicate of the list in the hands of the delivery clerk. From the tickets left with him by the delivery clerks he enters the amounts received against his bank from each of the others and determines whether his bank has a debit or credit balance.

The settling clerk then makes a ticket, showing the amount brought to the clearing house by his bank, and the amount other banks brought against it, in one total and the net result. This is sent to the manager and a copy is taken back to his bank for the use of the paying teller in adjusting his proof.

While the work on the floor has been going on, the clearing house clerk at his desk makes similar records from tickets sent to him from the floor, and when the

totals are in balance the work for the day is over. If the work does not balance, the floor men begin an active hunt to locate the error. When the work is proved, the manager reads the totals of the various banks in thousands. These totals are taken down by the men for the use of their respective banks during the day. These figures show how each bank stands with the clearing house for the day, some being debtor banks and some creditor.

Settling the Balances.

- Formerly the debtor had until a certain hour (12 30) to send the amount due to the clearing house, and the creditor banks appeared at a stated hour (1 30) and received the amount due them, in cash or clearing house certificates. These are certificates in large denomination, for gold and lawful money deposited with the clearing house, and used only between banks. They eliminate the use of money in all but the minor adjustments. But since the clearing has been done through the Federal reserve bank, the clearing house manager now sends a certified list of the balances to the Federal reserve bank and it debits or credits the amounts to the various banks, which then have additional or lesser funds on deposit with the Federal reserve bank, as the case may be. Thus the use of money or its representative is entirely eliminated.

It is obvious that the checks contained in the envelope must be examined for the same points as a check cashed over the counter would be, and this must be done in a few hours. By the rules of the clearing house these "go backs," as they are called, must be returned by a certain hour on the same day or they are considered paid. This is a harsh rule, and works hardship at times, but on the whole has proven most beneficial and

NEW YORK CLEARING HOUSE	
No. 67	New York Clearing House
	10/27 1921
Debit IRVING NAT'L BANK, Am't rec'd \$	108,765.79
Credit " " brought \$	201,757.40
Debit Balance due Clearing House.	
Cr. balance due IRVING NATIONAL BANK \$	92,992.11
	<i>A. B. Brown</i> Settling Clerk

Form 18—Clearing house ticket.

NEW YORK CLEARING HOUSE	No. 67	New York Clearing House
	<u>10/2</u>	<u>1921</u>
	Credit IRVING NATIONAL BANK \$ <u>92,992.11</u>	
177 2m 7-25	<u>M. B. Brown</u>	<u>Settling Clerk</u>

Form 19—Clearing house credit slip

expeditious By the New York rule, the banks have another clearing at 3 o'clock for the unpaid items, which are then adjusted between the various banks

There is a scale of fines running from one to three dollars for various offenses against the rules, such as tardiness, missorting a check, errors in tickets, misconduct, etc , which are rigidly enforced

There can be no doubt but that the clearing house is the last word in bank economy, both in time and the use of money, and from the use of money as a settling medium has ascended to the use of pure credit, no money passing between the debtor and creditor banks at all

City Collections.

The New York Clearing House also collects city items sent by its members before 10 o'clock Items for each bank are enclosed in envelopes and the contents indicated on the outside The clearing house prepares a route sheet upon which is entered the amount to be collected from each bank, and sends the same out by messenger. When the collection items are sent to the clearing house, receipt is given, which is turned in the next day and the receipt is cleared in the usual way The drawee banks pay the clearing house by check on a clearing house bank There are several large banks that pay their checks in the above manner

"Sent Wrong" and Fines.

Where items are sent in error to a bank, and consequently cannot be paid, they are sent back to the offending bank by messenger, and the fine collected in addition to the amount of the item Where the fine is against the bank, it is paid and charged to the "fine

account" and at the end of the month as a corrective measure a pro-rata charge is made against the clerks who made the errors. Some banks charge only a portion to the offender as a penalty on carelessness. Fines received from other banks are of course, credited to the same account.

CHAPTER IX

COLLECTING OUT-OF-TOWN CHECKS

The term "transit item" is used to designate a check on an out-of-town bank which has been received as cash, and which must be turned into a reserve balance at the earliest moment. The depositor exchanges a check for a bank credit, treats the credit as cash, and draws on it, or would like to, without delay. Banks collect checks on all parts of the world, but the major part of their collections are in the United States, where the check system has reached its highest attainment. Large business concerns daily receive checks from all parts of the country, and even in a country bank it is surprising how many "foreign" checks are received during the course of the day.

The turning of a check into "usable" funds resolves itself into creating a credit with a reserve bank in a large city, which deposit or credit may be counted in the bank's reserve, or a credit with the Federal reserve bank, which is likewise regarded as cash on hand. Cash is seldom received in payment of transit items.

Collecting Through Correspondents.

In the development of banking, banks have established relations with other banks in all parts of the country. And with these banks the collecting bank has reciprocal arrangements, among which are (a) That the correspondent bank will remit for the items on the day received, in a form that will be available as reserve, chiefly a draft on a New York, or Chicago bank. (b) By carrying an

open account with the correspondent bank, which may be a continuing balance, or settled weekly or oftener, by

Rockville Centre, N. Y. May 24, 192- REMITTED BY BANK OF ROCKVILLE CENTRE TO IRVING NATIONAL BANK NEW YORK CITY For Collection and Credit				ENDORSER		AMOUNT		ENDORSER		AMOUNT	
John C Thompson Howard Klein Chas E. Foster F S Coleman				237		50					
				40		77					
				112		13					
				197		03					
				587		43					

Form 20—Transit letter

draft on New York. Under these methods, for example, the Irving National Bank in New York would have correspondents in all large cities. If it had a check

on an Omaha bank, it would send the check to its Omaha correspondent. The latter would remit in the form of a draft on another bank in New York, which the Irving would collect through the clearing house the day after its receipt. Or, the Irving might have a running account with the Omaha bank, the latter sending all its New York checks to the Irving and the Irving sending all its Omaha items to the Omaha bank. In fact, the Omaha bank might collect all checks in Nebraska for the Irving, and the Irving might collect all checks in New York State for the Omaha bank on agreed terms. The balance in the Omaha bank due the Irving would be included in "due to banks" on its books, and the amount on the Irving's books due from the Omaha bank would be included in the amount "due from banks," in its statement. By such arrangements large banks are enabled to collect checks on any part of the country through their own correspondents. Under the clearing house method mentioned under that head, the clearing house would agree to collect all checks in a certain territory. It would then assemble the checks from its members on each bank in its territory and send the same in one letter daily, rather than have each member send its own checks direct, thus necessitating many letters from many banks as against one letter from one central source, containing all checks on that particular bank for that day.

Check Collections Through the Federal Reserve Bank.

Under the Federal Reserve System, the Federal banks hold themselves out as willing to collect checks from member and non-member banks in all parts of the country at par, and on January 1, 1921, checks could be collected at par on all but 1,755 out of 30,523 banks. Thus a bank, being a member of the Federal System,

sends all its checks to the Federal reserve bank, and it assembles checks from hundreds of banks, sorts them out, and sends all checks on a certain bank direct to it, daily (see page 106 for further treatment).

The collection of checks through correspondents has three main advantages to the country banks, as will be seen by a typical example. Prior to the opening of the Federal reserve banks, the First National Bank of Poughkeepsie was required to carry a lawful reserve of 15 per cent of its deposits, part in cash and part on deposit in New York, Boston, Philadelphia, etc. Any balance to its credit in banks in those cities, qualified to act as reserve banks, was regarded the same as cash on hand. The Poughkeepsie bank would send its checks every day to its various correspondents, and as soon as the letter was in the mails, the amount was considered reserve and so counted. Moreover, the Poughkeepsie bank received interest at about 2 per cent. on its balances in the other banks. At the same time it received checks from its correspondents, on certain banks in its territory for the collection of which it received "exchange." These practices have been abolished by the Federal reserve banks. Checks are not reserve until collected. Interest is not paid on Federal reserve balances, and exchange as a general practice no longer obtains.

The elimination of these practices has, of course, worked some hardship to the country banks, in that reserve is not reserve until actually created, and exchange profits have been done away with. The loss of interest on reserve balances has cut into profits to a considerable degree, but there are many offsetting advantages that compensate the banks for membership in the Federal system. At any rate, banking procedure is more scientifically performed, and certain unwise practices that heretofore obtained have been made impossible.

Check Collections at Par.

Under the Federal Reserve Act, the Federal banks are given the power to collect checks, and thus they have essayed to do, first charging a flat rate of about $1\frac{1}{2}$ cents per check, and ultimately at no cost to the member banks, so that at present the Federal reserve banks collect checks on nearly 30,000 banks at par, or, in other words, they have eliminated the exchange charge. In order to do this they have arranged with banks in all parts of the country to remit for checks drawn on them at par the day received, or to carry accounts with the Federal banks, to which their checks are charged and to which checks sent by them are also credited at par, subject to certain delays.

There is now under way a studied and study attempt on the part of country banks that have been induced or compelled to remit at par for checks drawn on them, to continue to charge exchange, thus adding to their profits, but this is a localized effort only, and it is but a question of time when all banks will pay their checks at par and the bank check in this country will be worth its face value anywhere.¹

In building up a transit department, banks have made reciprocal arrangements between themselves as to the basis upon which one will collect checks for the other. First, there is the balance, with or without interest, maintained, one with the other, second, one bank agrees to send all items on a certain territory to the other, at an agreed rate of exchange; and each seeks a profit by "bunching" its checks and collecting for a less amount than it charges, thus making a profit. A third method consists in this arrangement. The city bank will agree to collect all checks at par, but credit is not given until a certain number of days have elapsed, thus giving the

¹ See pages 117-126 for full discussion of this subject.

bank time to make the collection before the funds can be drawn upon, or interest is credited thereon. Thus, for instance, bank A in New York will collect for bank B on Long Island, all out-of-town checks at par, giving credit three days after their receipt. It depends altogether upon the character of the checks whether this arrangement will be profitable to the collecting bank. Thus, a deposit is received, containing the following checks

\$1,000 on Bridgeport, Connecticut (Bank receives returns on the third day)

\$1,000 on Atlanta, Georgia (Bank receives returns in four days)

\$1,000 on Dallas, Texas (Bank receives returns in 8 days)

\$1,000 on New York (Bank receives returns in one day)

\$1,000 on Los Angeles, California (Bank receives returns in 10 days)

It is obvious that if the \$5,000 were withdrawn on the third day, the New York bank would advance \$1,000 for 1, 5 and 7 days respectively, but if all were New York checks, it would be the gainer by two days. It all depends upon the nature of the deposits whether this plan works to the profit of either bank. Some banks make this a steady practice and have built up a large line of bank deposits on this idea.

Federal Reserve Collection System.

The Federal reserve transit department contemplates collection of all country checks at par, but does not give credit for the amount until time has elapsed sufficient to present the check by the fast mails, and the country has been divided into zones of one, two, four and eight days. A check on California would be credited or become "available" on the eighth day (The time is based upon the time required to send the check to the bank

drawn on, plus the time required by the Federal bank making the collection to receive funds in return)

Members of the Federal Reserve System are now required to carry all their reserves in the Federal reserve bank of the district in which they are located. In order to build up this balance they send their out-of-town checks for credit, and checks on them are charged to their account by the Federal bank after sufficient time has elapsed to reach them and have payment effected. Checks may now be collected at par through the Federal reserve banks upon (a) Banks that are members of the Federal System, (b) other Federal reserve banks, (c) checks drawn upon non-member banks, which are members of the clearing houses of the twelve Federal reserve districts, (d) banks which have agreed with the Federal reserve banks to remit at par.

Illustration of Deferred Credit.

The following illustration is taken from "Practical Bank Operation," to show in practice how this plan works out.

The New York Federal Reserve Bank receives a deposit of \$70,000 composed of.

Check on First National Bank, Brooklyn (one day point)	\$26,000
Check on Bank of Detroit (two day point)	20,000
Check on Hibernia Bank and Trust Co , New Orleans (four day point)	14,000
Check on Exchange National Bank, Tulsa, Oklahoma (eight day point)	10,000

The New York Federal Reserve Bank will credit the depositing bank with \$70,000, but only the Brooklyn check, payable the same day, if received before 9 o'clock, will be available as reserve or to be drawn against. On the second day the Detroit check will be available, on the fourth day the New Orleans check becomes

available, and on the eighth day the Oklahoma check is considered paid and is available.

In collecting checks through the Federal reserve banks, the collection system has reached its highest perfection. Thus, for instance, a New York bank will send all its local checks that it does not collect through the clearing house to the New York Federal Reserve Bank. These checks immediately become a cash credit. Other checks collectible through the Federal System are sent to the Federal reserve banks of the district where the drawee banks are located. The New York bank advises the Federal reserve bank of the district to credit the Federal Reserve Bank of New York, and this it will do.

Advice of such items is sent to the New York Federal Reserve Bank, and when it receives its credit the advice is checked against the original advice from its local member bank. As a matter of fact the amount is credited to the New York bank as soon as sufficient time has expired to make the amount available in the other Federal reserve bank.

The Gold Settlement Fund.

Again, to show the elimination of the use of money in banking clearance operations, may be mentioned the Gold Settlement Fund, held in Washington for the account of the various Federal reserve banks. It is obvious that in the vast clearance of bank checks, one Federal reserve bank will owe another. Settlement could be made in cash by express, but that is costly and risky. Therefore some wise head conceived the idea of creating a vast block of gold, or its equivalent, in a central place, and dividing it up from time to time. In the year 1915 each Federal reserve bank deposited a million in gold or its equivalent, with the U. S. Treasury,

plus an amount equal to the bank's indebtedness to other banks. Every evening each Federal reserve bank telegraphs to Washington the amount due to the other banks of the system, and the Washington authorities debit and credit these amounts. Thus if New York owes Boston, New York's share of the block of gold will be less and Boston's share will be more. The next day Boston may owe New York and New York's share will increase and Boston's will diminish. I consider this unique use of credit sustained by a foundation of gold equal in its conception to the settling of the clearing house balances through the Federal reserve bank.

Work of the Transit Department.

The transit department is in charge of a transit man (or woman) who is responsible for turning the bank's checks into available funds to the best advantage. Where a large check is presented, he must determine the quickest and cheapest method of turning it into reserve. For instance. A check on a Kansas bank may be sent direct to the bank drawn on and exchange paid, he may send it to his Kansas City correspondent and receive a New York draft in four days, at par, he may collect through the Federal System with a delayed credit at par. In one instance he pays exchange and has the funds in hand a day or two earlier, and thus has the use for loaning purposes, but pays a toll; while in the other he pays no toll but loses one or two days' interest. He must quickly decide how to make the most advantageous collection.

The transit department collects all out-of-town items, computes the exchange charges and records the "interest delays" or delayed credits.

In some large banks the large out-of-town checks are sent out the same day, while the small checks are held

over from the afternoon work until the next day, while in others all checks received up to a certain hour are sent out, and the day's work is completed when the force is dismissed.

The transit letters are now made in duplicate by special machines, which record not only the amount, but special instructions, such as "to protest," "wire fate," etc. The duplicates are used as charge tickets to the banks where sent. The last indorser is also taken, for identification of the check in case of loss in the mail. It is apparent that if the teller has a record of the bank drawn on, and the transit department of the indorser, a check can be replaced—provided the indorser's record will trace the maker of check, as it should.

All that has been said above applies equally to the small bank where the transit department is a girl and an adding typewriter, and essentially the same work is done at one desk as is done in a whole department.

Indorsement of Transit Items.

All items sent out by banks, either for collection or as cash items are indorsed with a rubber stamp or indorsing machine the usual forms being those shown on page 111. One form makes them payable to "any bank, banker or trust company" and all prior indorsements are guaranteed. In the large banks a self-addressed post card to be used by the receiving bank to acknowledge the receipt of the letter is enclosed. It is essential that letters containing checks running into large amounts be watched carefully and their receipt in due course ascertained, so that in the event of loss in the mail or theft of the letter, prompt action be taken, and all well-managed banks give heed to such matters.

As soon as the transit letters are prepared and proven, they go to the bookkeepers to be charged against the

banks to which they are sent. Where the items are sent out on a collection basis, they are charged as "collections outstanding" to distinguish them from *transit* items, and as fast as payment is received it is credited out. The balance represents the amount of

RECEIVED PAYMENT Through City Collection Department of the Federal Reserve Bank of New York MAY 11 1921 Irving National Bank NEW YORK P. F. GRAY, Cashier	Pay THE IRVING NATIONAL BANK of NEW YORK, or order, All Prior Endorsements Guaranteed JUN 18 1921 BANK OF ROCKVILLE CENTRE 50-494 <small>ROCKVILLE CENTRE NEW YORK</small> 50-494
	PAY TO THE ORDER OF ANY BANK OR BANKER All Prior Endorsements Guaranteed JUN 18 1921 BANK OF ROCKVILLE CENTRE 50-494 <small>ROCKVILLE CENTRE NEW YORK</small> 50-494
(b)	(c)

FORM 21 —Indorsing stamps

collections outstanding. This latter is the proper function of the collection department and is so treated in departmental banks. Items not reported promptly after their due date are traced and their fate inquired into.

CHAPTER X

EXCHANGE

The reason for and meaning of the word "exchange" as used in banking is unintelligible to most students of banking, and it will be well to explain its significance here. We have seen that all banks are required to carry a reserve fund, part of which must be in cash and part may be in certain other banks, termed legal depositories¹. The latter are such banks located in the large cities, as qualify as to capital and surplus under the law. These banks are selected by a majority of the board of directors, irrespective of directors who may be directors of the bank in question. The reserve bank must also be approved by the Comptroller of the Currency or the superintendent of banks. Therefore the balance in a depository bank is "reserve". To create and maintain this balance, the local banks must ship currency by express or registered mail, let us say at a cost of 50 cents per \$1,000.

By law a bank is required to pay its checks in cash over the counter on demand. Let us assume that the Bank of Erie, Pennsylvania, has a check on a bank at Jamestown, New York, for \$1,000. It could send a messenger and demand cash, but this is expensive. It could send the check by express likewise and demand cash. It does not want the cash, but it does want a

¹ These observations apply to the period prior to 1914, when the Federal reserve banks were opened. Under the Federal System cash in vault is optional and reserve in Federal banks is mandatory. However, the statements are still true as regards a large number of state banks and trust companies.

reserve balance in the Irving National Bank in New York. It therefore sends the check to the Jamestown bank with request for a "draft on New York," or "New York funds," as they are sometimes called. The Jamestown bank in reply says "We are willing to pay this check in cash at our counter but if you want a check on New York, we will have to cover it by shipping \$1,000 in cash by express, and that will cost us 50 cents. We will charge you the 50 cents as our reimbursement." It therefore deducts 50 cents "exchange," and sends its draft on the Irving National Bank where it has an account.

The Erie bank, not willing to assume this expense for collecting the check, charges the customer who deposited it the same amount, also as exchange. By the rules of certain clearing houses, notably New York, banks are forbidden under heavy penalty to bear this expense and must assess the customer the amount.

As a matter of fact, it may have cost the Jamestown bank a mere trifle to create the balance in the Irving, for it has received certain checks on New York banks, which it sent to the Irving for credit, and the cost has simply been for stationery, clerk hire and postage. In many banks this exchange has been a large item and is one of the incidental profits of banking.

Where the clearing house rules require the bank to charge the customer, the collecting bank may also show a profit in this wise. Suppose the Erie Bank, during the day, receives ten checks on the Jamestown bank, aggregating \$1,000, on each of which it charged, to the various customers, 10 cents "exchange"—the minimum charge permissible. It could collect the total checks for 50 cents, thus taking a profit of 50 cents for itself after paying the Jamestown bank the charge exacted.

In order to attract deposits, certain banks, not under

clearing house rules, have specialized in country check collections, and have agreed to collect checks at par—for a consideration, the consideration being a balance sufficient to offset the cost and show a profit.¹ Let us see how it works out by example, applying an actual case to the point

The Costliness of Exchange.

The Long Island Bank agrees with the Irving Bank to collect all checks on Long Island points at par, provided the Irving will carry a balance of \$5,000 with it, on which it will pay the Irving 2 per cent. interest. Every morning the Long Island Bank receives a batch of checks on Long Island banks, for account of the Irving. These it sends out to the banks drawn on, and when it receives New York drafts in payment the second day after, finds the Long Island banks have deducted an average of \$3 a day for exchange. One day the cashier of the Long Island Bank sharpens his pencil and figures out what he gets out of this arrangement, thus:

Irving balance	\$5,000
Reserve required against it (say 15 per cent)	750
	<hr/>
Balance to loan out at 6 per cent	\$4,250
Yearly income	255
Cost to collect	
Postage 50 cents a day	\$150
Exchange per day \$3 (300 days)	900
Interest on \$5,000 at 2 per cent	100
Loss on this account per year, not including clerk hire and stationery	1,150
	<hr/>
	\$ 895

He can cover himself in several ways (a) Require a larger balance, (b) discontinue interest on the account, (c) charge the exchange to the Irving, etc., etc.; and only an analysis of each account will determine its profit or loss to the bank. The same principle applies to any account,

¹ Certain clearing houses also allow member banks to waive exchange on check collections and to bear the cost themselves

individual or corporate, bank correspondents, or local customers

Assessing Exchange Charges.

The rules of the clearing house govern the collection of exchange. The checks subject to exchange are divided into two classes (a) Items on which exchange must be collected, and (b) items on discretionary points—that is checks on banks which may or may not charge exchange at the discretion of the bank. A table of charges is prepared, classifying these items into (a) checks or drafts upon banks, bankers or trust companies, (b) bankers' acceptances, (c) other items, classified by states. The charges upon exchange items run from discretionary to one-fourth of 1 per cent, and are based upon the mail time required to make the collection.

The transit department is charged with the duty of making these charges according to the rules in force. There are exchange sheets for each customer of the bank, and on these sheets are entered the exchange charges to be assessed back to the account. These sheets show the date, where payable, amount and exchange charge. At the end of each month the amount for the month is charged to the depositor. Where the exchange is paid at the time of making the deposit, the amount is turned over to the proper clerk for credit as exchange and no further charge is made on the item. Some customers prefer to pay by their own check, and bill is rendered accordingly. Exchange received from collections is likewise credited to exchange account from the collection department.

Interest Delays

In many cases the bank pays interest upon the daily balances, and it is obvious that if it pays interest on all sums deposited, it is paying on money which it does not

receive for several days and would lose large amounts in interest if all checks were treated as cash deposits. If the customer pays exchange, it is assumed that the exchange charge offsets any loss of interest and the amount is entitled to interest from date of deposit. On all other items the interest does not begin to run until time has elapsed sufficient to make the collection and turn the amount into reserve.

It is obvious from the foregoing that each deposit must be examined, whether received over the counter or by mail, the exchange computed and collected in one way or another, and the interest delays also computed and deducted from the monthly interest credit. This is done by making a list of items held out each day for each customer and deducting the total from the total of the deposits as shown by a total of the ledger balances. Thus the customer may have a total of \$1,600,000 representing his balances for the month, minus interest delays of \$180,000, leaving the balance entitled to interest at the agreed rate.

The intricate procedure outlined above can only be followed in the large banks where special clerks are charged with these details. In the small banks such minute detail would be quite impossible and would cost more than the amount conserved would warrant.

The Controversy Over Exchange Charges

The element of exchange has played an important part in banking procedure in days past, and formed no small part of some banks' profits. Under the régime of the Federal reserve bank, exchange has been practically eliminated in this country, but its friends have not given up the fight, and there is a bare chance that it may once more become a feature of our banking operations.

In the controversy that has been waged around this

question, between banks that have adhered to the charge for exchange and the Federal reserve banks that have been fighting to eliminate the charge altogether, both sides of the question have been well stated. The affirmative is argued in injunction proceedings in the Superior Court of Georgia, and is a clear and concise statement of the reason for charging exchange in banking transactions. The court says

The Argument for Exchange

"One of the fundamental and important functions performed by the commercial banks is the use of checks payable on demand, drawn against deposits in said banks, which are used in commercial transactions in lieu of actual money. Petitioners are informed that the best estimates on the subject place the performance of checks as a medium of exchange, as compared with the use of actual currency, as twenty to one. Through this instrumentality the medium of exchange is thus increased twenty-fold.

"The bank check is the instrument by which customarily a depositor seeks to withdraw his funds, or any part thereof, from the bank. It is a draft or order on the bank requiring it to pay a sum named. The initial and primary obligation of the bank upon which such a check is drawn is to pay the same over its counter in current funds on demand, charging the amount of the same against the deposit account of the drawer of said check.

"A custom has grown up in the banking business, however, whereby a great majority of checks thus drawn against accounts are handled through banking channels in such a manner as that they reach the several banks upon which they are drawn through the mails by correspondence between the banks handling such checks. When checks are thus sent through the mails, a service is demanded of the bank upon which they are drawn in excess of the mere payment of such check, some of the elements of which may be thus enumerated:

New York Exchange

"A record must be made showing from whom said check was received and the amount thereof entered up in such record. The party transmitting said check, not being a resident of the same place in which the drawee bank is located, expects a remittance of the proceeds of said check in funds available at the place of the sender's

residence or else in New York exchange, which by universal custom has come to be current throughout the country. It thus becomes incumbent on the drawee bank to maintain at different financial centers funds which may be drawn upon to cover remittances necessary to cover proceeds of checks thus sent to it through the mails. These funds are maintained by such banks through the medium of deposits to its credit in banking institutions located in such financial centers, which deposit account must be maintained in amounts adequate to meet the average necessities of said drawee bank. To maintain these balances against which such remittance drafts are drawn, the drawee bank must transmit funds from time to time to such depositories and pay the cost of such transmission. In addition to this, the draft covering the proceeds of the check must be written up by competent clerical force and duly recorded on the records of said bank and properly charged to the account of such correspondent. And when the transaction is completed of record in the drawee bank, letters of remittance must be prepared by competent clerical force and postage paid for the return of such remittance to the correspondent through the mails.

Meaning of Exchange.

"The services thus required in the drawee bank to handle checks drawn upon it and sent through the mails, as above described, necessarily increase its expenses of doing business. This service inures directly to the benefit of the payee or original recipient of said check and subsequent holders thereof by indorsement in regular course of business and is the primary means through which checks have come to be so large an element in the media of exchange in lieu of actual currency. In order to compensate for this service it has long been the universal custom of banks, except in the matter of checks drawn between large financial centers, to make a charge of a fraction of a per cent of the amount of such checks, which is deducted from the proceeds thereof and is commonly called 'exchange'. The word 'exchange' as here used should not be confounded with the meaning of the word as applied to drafts on funds in financial centers commonly called 'exchange'. The word 'exchange,' as applied to the charge for the service rendered in remitting checks through the mails, means compensation for such service. It is entirely proper that the expense involved in handling checks through mails and correspondent banks should be borne by the payees or indorsers of said checks (who receive the proceeds thereof) for the reason that said

checks are issued in payment for merchandise or in settlement of other business transactions in which such payees enjoy the profits involved in their particular business, and the compensation for the service rendered by the bank is a small but appropriate expense of doing such business and should be borne by the party receiving the profits thereon

"Your petitioners are informed and so allege upon information and belief that the aggregate value of such service rendered by the country bankers in the State of Georgia would reach the total of a million dollars per annum

Collection Costs.

"Petitioners are informed and so allege upon information and belief that the Atlanta Clearing House, which is an association of the largest banks in the City of Atlanta, the capital of the state, and the largest association of the kind in the state, charges \$1 11 per thousand dollars for such service in connection with checks handled through said association, and your petitioners charge that said amount is substantially the correct estimate of the cost of said service

"The customary charge of the country banks for said service is on the average about one-eighth of 1 per cent on the amount involved, which covers the actual cost of the service rendered and about 12½ per cent profit thereon

"Your petitioners charge that compensation for said service constitutes one of the most important sources of revenue of the country banks and the continuation of the right to make such charge is essentially important to their continued prosperity and to the performance of their functions under the policy of the State of Georgia under which they are regulated, and to the performance of their functions in the general growth and prosperity of the rural communities of the state

"In addition to the economic value of the service thus rendered and the enlargement of the use of such checks in the business of the country through correspondents, as above explained, the great hazards of handling so large a volume of transactions by the use of currency are avoided. Opportunities for theft and defalcation are reduced to a minimum and the expenses of transmission of actual currency, burglary insurance and the proper care and safeguarding of money are brought down to the lowest level

"When a bank foregoes any charge for the collection and remit-

tance service, hereinbefore described, and forwards draft to cover the amount of any such checks so sent through the mails without any deduction for said service, the banking term employed in such a case is called remitting at par "

The Argument Against Exchange.

The development of the par collection service of the Federal reserve banks is well set forth in the report of the Federal Reserve Board for 1920. It also gives the answer to the claim that banks are entitled to this source of income, by showing how the cost is borne by the Federal reserve banks, and reviews the operation of the gold settlement fund. The startling fact is mentioned, that if the Federal reserve banks had been obliged to pay exchange at the rate of ten cents per hundred, the cost to them would have been more than \$135,000,000, or more than the total net earnings of the Federal reserve banks. A reading of the extracts from the report herewith presented will prove both enlightening and profitable. The report says:

Progress of Par Collection.

"On January 1, 1921, checks on all but 1,755 of the 30,523 banks in the United States could be collected at par. These 1,755 banks are all located in the following seven states of the Southeast: Tennessee, South Carolina, Louisiana, Mississippi, Alabama, Georgia and Florida. Consequently, every bank in 9 of the 12 Federal Reserve districts is on the par lists, the three districts in which there remain any non-par banks being those of Richmond, Atlanta and St. Louis. This development in the check clearing and collection system has been accomplished in the face of continuous opposition on the part of some member and non-member banks. It is evident that as the merits of par collection are becoming more widely known fewer banks are participating in the opposition, but the banks which continue to oppose par collection are well organized and their opposition appears to be as vigorous as ever.

"In order to present clearly the issue involved in the controversy over par collection, it is necessary to review the history of the

development of the check-collection system under the Federal Reserve Act * * *

"The provisions of the Federal Reserve Act which relate to check clearing and collection were last amended by the Act of June 21, 1917. Section 16 provides that the Federal Reserve Board may act as a clearing house for the Federal reserve banks and may require those banks to act as clearing houses for their member banks. Section 13, as amended by the so-called Haidwick amendment of June 21, 1917, provides that Federal reserve banks may receive on deposit checks and drafts payable upon presentation, the checks which those banks are authorized to receive on deposit not being limited, as they were prior to the amendment, to checks on solvent member banks. The proviso at the end of the first paragraph of section 13 reads

"That nothing in this or any other section of this Act shall be construed as prohibiting a member or non-member bank from making reasonable charges, to be determined and regulated by the Federal Reserve Board, but in no case to exceed 10 cents per \$100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise, *but no such charges shall be made against the Federal reserve banks*

"As construed by the Attorney-General, and as recently held by the United States Circuit Court of Appeals, Fifth Circuit, these provisions prohibit the Federal reserve banks from paying exchange charges to member or non-member banks.

"It is apparent that if Federal reserve banks in their capacities as clearing houses are to render full service to their member banks, they must clear checks drawn on all banks including those non-member banks, now few in number, which decline to remit at par. Consequently, the Board has approved the action of the Federal reserve banks not only in soliciting non-member banks to agree to remit at par but also in collecting by presentation at the counter checks drawn on non-member banks which decline to remit at par.

Opposition to Par Collection.

"Opposition on the part of the banks against par collection has taken various concrete forms. Since Federal reserve banks cannot pay exchange charges, when non-member banks refuse to remit at par the Federal reserve banks have no choice, if they are to collect the checks drawn on those non-member banks, but to make presentation of such checks at the counters through selected agents. These agents

may be employees of the Federal reserve banks or may be banks, express companies, or any other suitable agents located in the same town. The employees and agents of the Federal reserve banks have encountered various obstacles in making presentation of checks, such as the tender of payment in a manner calculated to take as much time as possible, or the refusal of payment in reliance on the inability of the agent to find a notary public willing to make protest. The Board has been advised of one instance where a duly appointed agent has within a few days after appointment given notice to the Federal reserve bank that he would no longer act as agent for fear of injury to his business.

"Other banks, including some member banks, have resorted to the device of stamping legends on their blank checks to the effect that the check is not valid if presentation is made through the Federal reserve banks.

"On January 22, 1920, a number of non-member banks filed a petition in the Superior Court of Fulton County, Ga., for an injunction restraining the Federal Reserve Bank of Atlanta from collecting checks drawn on the plaintiff banks in any manner other than through the mails.¹ The suit was transferred to the United States District Court for the Northern District of Georgia, which dismissed the complaint upon the merits. The decision of the district court was affirmed by the United States Circuit Court of Appeals for the Fifth Circuit on November 19, 1920, and the case has now been appealed to the Supreme Court of the United States. The restraining order, obtained by the plaintiff banks at the commencement of the suit, has been continued pending the appeals to the Circuit Court of Appeals and the Supreme Court of the United States, and this accounts in large part for the fact that no material progress has been made by the Federal Reserve Bank of Atlanta in adding to the number of banks whose checks it can collect at pay.

State Legislation.

"The legislatures of five states, namely, Mississippi, Louisiana, South Dakota, Georgia and Alabama, have enacted laws for the express purpose of preventing the Federal reserve banks from collecting, at par, checks drawn on the banks located in those states. The Mississippi law purports to require all banks within the state, including national banks, member banks, and non-member banks, to make charges for collecting and remitting cash items which are presented

¹ This decision is quoted in the preceding pages.

to the payer bank for payment through or by any bank, banker, trust company, Federal reserve bank, post-office, express company, or any collection agency, or by any other agency whatsoever. The laws of the four other States are not mandatory, but merely purport to give to all banks within the respective State the right to make similar charges. The laws of Mississippi, Louisiana, South Dakota and Alabama prohibit any officer of the respective State from protesting any check for non-payment, when such non-payment is on account of the refusal of any such agency to pay exchange, and the laws of Mississippi, Louisiana and South Dakota further provide in terms that there shall be no right of action, either at law or in equity, against any bank in this State for a refusal to pay such cash item, when such refusal is based alone on the ground of the non-payment of such exchange. The Federal Reserve Board has taken the position that these laws are clearly unconstitutional in so far as they purport to require national banks, and State banks which have joined the Federal Reserve System, to make exchange charges against Federal reserve banks.

"The Board has obtained no opinion as to the constitutionality of the laws in so far as they purport to affect non-member State banks, believing that this is a question which can be settled only by the courts. Prior to the enactment of the South Dakota and Louisiana laws, all banks in South Dakota, and in that part of Louisiana which is located in the Eleventh Federal Reserve District, had been placed upon the Federal reserve bank par lists, and the Federal Reserve Banks of Minneapolis and Dallas have since the enactment of those laws continued to receive for collection at par all checks drawn on those banks. * * *

"In view of all the circumstances, and at the request of some of the opponents of par collection, the Board concluded to present the facts to Congress for such action as that body might care to take. In accordance with this determination the Board on May 5, 1920, addressed a letter to the chairman of the Banking and Currency Committee of the House of Representatives. In this letter the Board called attention to the persistent opposition to par collection and to the obstacles which the Federal reserve banks were encountering, and suggested that the committee might deem it advisable to consider whether the par collection of checks should continue to be a function of Federal reserve banks, with a view to recommending a further amendment to the law which would either remove the obstacles standing in the way of par collection at the present time or

permit both member and non-member banks to make exchange charges against the Federal reserve banks, such charges, of course, to be reimbursed to the Federal reserve banks by the banks sending the checks for collection

Advantages of Par Collection.

"The Board is thoroughly convinced of the advantages of a universal system for the par collection of checks, and it brought the matter to the attention of Congress, not because of any doubt on its part as to the effect of the law, but because the issue involved the propriety of the legislation itself. The Board has frequently had occasion to point out that in their origin exchange charges were justified on account of the necessity for, and the high cost of, actually transporting currency, but that under existing conditions those charges can be justified upon no scientific or economic principle, since the payment of checks at places other than where the drawee banks are located involves little expense and that is borne by the Federal reserve banks. Even the banks which decline to remit at par to the Federal reserve banks receive the benefits of the Federal reserve check-clearing facilities by having the checks which they receive collected through a correspondent bank which is a member of the Federal Reserve System, although they contribute nothing to the strength of the system. To the extent that the practice of charging exchange is continued under the operation of the Federal Reserve System, it is an anachronism which permits the charging banks to impose a charge upon commerce and industry after they have ceased to perform the service which in former times justified the imposition of such a charge. In this connection the following is quoted from a letter dated April 1, 1920, addressed by the Board to a United States Senator

Cost of Money Transfer Eliminated.

"Since the establishment of the Federal reserve banks the cost of transferring balances from one section of the country has been almost entirely eliminated. Each Federal reserve bank carries a portion of its gold reserve in a gold settlement fund, which is kept in the Treasury at Washington, and there is a daily telegraphic clearing conducted by the Federal Reserve Board for all 12 banks and for their branches. The amount of gold in the fund is practically a stable quantity, but its ownership varies from day to day, according to the debits and credits to the different banks. Transfers are made by the Federal reserve banks for member banks and also for non-member banks

through the medium of member banks, by telegraph, without any charge whatever to the member bank or its client, all costs being borne by the Federal reserve banks. Thus a bank in Wisconsin, or California, Maine or Texas, can secure an instantaneous transfer to any one of the 12 Federal Reserve cities or to the 20 cities where there are branch Federal reserve banks without any expense whatsoever, and the sum total of these transfers is settled daily through the gold settlement fund above referred to. The Federal reserve banks pay all costs of transporting currency to or from their member banks, as well as transportation charges on currency sent them by non-member banks in payment of checks.

"The total volume of transactions through the gold settlement fund in the year 1919 was approximately \$74,000,000,000, and the total cost, including the expense of the leased wires, was about \$250,000. This cost was borne by the Federal reserve banks and does not represent any expense whatever to the member banks or their customers. Thus it will be seen that the basic cost of making domestic exchange in the year 1919 was 0.3 of a cent for each \$1,000 transferred. A charge of 10 cents per \$100 on the amount cleared through the gold settlement fund would have involved an expense of \$1 for each \$1,000 transferred, or about \$74,000,000 for the entire amount.

"The intradistrict clearings made by the Federal reserve banks, eliminating duplications, amounted to about \$135,000,000,000, and the total expense of these transfers was borne by the Federal reserve banks. Had the Federal reserve banks been obliged to pay for these transfers at the rate of 10 cents per \$100, it will be seen that the total expense would have been \$135,000,000, which amount is far in excess of the total earnings of the Federal reserve banks and therefore could not have been absorbed by them. If not absorbed, the charge would have had to have been transferred to the depositors of the checks, so it will be seen that a charge of 10 cents per \$100 upon the business handled by the Federal reserve banks would have involved last year a cost to the commerce and industry of this country of at least \$135,000,000.

"The Federal Reserve Board believes that the present terms of the Federal Reserve Act impose upon it the duty of developing and maintaining the Federal reserve par collection system, while the opponents of par collection vigorously urge the contrary view. The opinion of the United States Circuit Court of Appeals, previously referred to, decisively upholds the Board's point of view, and, Congress having taken no action in the matter of further legislation on

the subject, the Board will, of course, regard as binding upon all parties the final interpretation of Section 13 of the Federal Reserve Act by the Supreme Court of the United States. Consequently, unless that court reverses the decision of the United States Circuit Court of Appeals, the Board will assume that Congress desires the Federal Reserve Board and the Federal reserve banks to continue, as heretofore, to develop and perfect the Federal reserve par collection system.

"Until the United States Supreme Court renders its decision in the appeal now pending before it, the opinion of the United States Circuit Court of Appeals must, of course, be regarded as conclusive as to the construction of the law. The following extract from that opinion sustains in every respect the position which the Board has always taken that its duty under the law as it now stands is to develop and perfect the Federal reserve par collection system.

Par Collections Not Malicious

"The principle that one must so use his property as not to unnecessarily and maliciously injure his neighbor, even though his act is otherwise lawful, is also invoked. Conceding that the accumulating of checks, and their presentation, when accumulated, with the intent to embarrass and injure the drawee bank, might constitute an actionable wrong and one that might be prevented by injunction, we do not think the amended bill presents any such case. There is no specific charge in the bill of any threat to present the checks in any accumulated or oppressive manner on which a court of equity would be justified in acting. Nor does the bill charge the appellee bank with acting from a merely malicious motive, if that is material. It does aver that the purpose of the appellee was to compel the appellants to accept the lesser of two evils and to remit at par for checks drawn upon it. If this charge was borne out by the exhibits, which it is not, it would not constitute legal duress, on which a legal complaint could be predicated. The exhibits show that the adoption of a system of universal par clearance was advocated in good faith by the appellee bank as a proper banking policy, and as well by Congress and the Federal Reserve Board. The adoption of appropriate means by the appellee bank to accomplish this end cannot with any propriety be attributed to malice on its part against appellants and other banks in like condition. Nor does the adoption of the method of presenting checks over the counters of the drawee bank imply an attempt to coerce them into becoming member or depositing banks.

The Federal reserve bank was interested to supply a universal clearance at par for its member and depositing banks. It could accomplish this only by accepting from its member and depositing banks all checks tendered it by them upon whatever banks drawn. If drawn upon a non-member and non-depositing bank which refused to remit at par, it was disabled under the statute from handling such checks through the method of transmission of the checks and remittance of the proceeds through the mails. It could only collect such checks by presentation in person to the drawee bank. It is therefore reasonable to suppose that its declared purpose of making such presentations was in furtherance of its policy of furnishing complete clearing facilities to its member banks, and was not for the purpose of injuring or destroying the drawee banks, or of coercing them into becoming member or depositing banks with it. It constituted an essential step without which universal par clearance was not possible of accomplishment."

CHAPTER XI

COLLECTIONS

The items which a bank in a large city receives as cash are turned into usable funds either through the clearing house, the Federal reserve bank or the transit department. There remain those items that are properly termed *collections*, which include notes, bills of exchange, coupons and dishonored checks which are given special attention in order to effect their payment. We must again distinguish between an item received as cash and one received for collection. In the former, credit is given immediately and the collection is made afterward. This credit is either a spot cash transaction, such as a clearing house item, or an exchange item where the cost of collection is collected or charged back. The right to draw is immediate, or nearly so. But a collection item is one which has the element of time connected with it. In other words, it has a due date.

This collection service rendered the banking public is important to the customer. The holder of a note need only turn it over to his bank and it will be presented at the place, at the time and to the party obligated to pay it, and if dishonored, proper steps will be taken to safeguard the rights of all parties thereto. If paid, the amount will be duly credited, and if dishonored, the item will be returned in due course with the reason stated. The same comment applies to drafts, bills of exchange and coupons.

As a matter of law, a bank in receiving a collection item does not become the owner, but is the owner's agent in making the collection. It is required only to use

\$1000⁰⁰ New York, Oct 3 1921
 Order of IRVING NATIONAL BANK
 NEW YORK
 One thousand _____ Dollars
 PAY TO THE
 Value received and charge same to account of

To John Doe & Co
 Address 150 Broadway
 No NY Richard Roe & Co

Form 22—Draft, or bill of exchange

255

due care and diligence in selecting its agents; but as a matter of fact, collections are given the same care as cash items, and more detailed records are made of them. Where a collection is made *gratis*, as many are, it is one of the unrequited services of the bank, and where a charge is made it is according to clearing house rules, or in cases where special care and services are required.

Classes of Collections.

We may divide collections into (a) outgoing, and (b) incoming. An outgoing collection is a note, bill of exchange, coupon or draft turned in by a customer for collection. Likewise are the notes held by the bank under discount and payable at a place other than its own counter, coupons from its own securities, maturing securities, etc., and collections of special nature such as deeds, satisfactions of mortgages, etc., to be delivered upon fulfillment of certain conditions. Class b will include items of the same nature *received* by the bank from business houses and banks, and drawn on customers or other parties reached by the bank's collecting machinery. For instance, a bank acting as a reserve agent for a country bank will receive notes, bills of exchange and coupons from its correspondent to be forwarded through the same channels as are transit items, but for collection only.

All banks also receive collection items from near and remote business houses for attention. For the latter service the bank exacts a fee for services rendered, inasmuch as it is a real service and not compensated for in any indirect way.

In the large banks where an item has failed of collection as a cash item, it is turned over to the collection department to be given further attention as a collection item. In the smaller banks returned items are put into


a "collection account," which is in substance the same as the collection department of the large bank

The Messenger.

Closely associated with the collection department is the messenger work, which employs "runners" who make these collections by hand. In the large banks the collection of notes and coupons is handled by the note teller and coupon department, respectively, and this work is segregated from the other collections above mentioned. Large items are frequently sent out by messenger to effect their prompt payment, rather than send them through other channels that would delay payment by a day; but clearing house items must be collected through the clearing house exchanges.

The items to be collected are sorted out according to prescribed routes and listed on sheets. The original goes with the messenger and the duplicate is kept in the bank, and records the name of the maker, the amount, the place of payment and the fate of the item. If the item is unpaid, it is protested unless protest is waived and the fees are charged back, with the face amount of the item, to the party from whom it was received, if on a cash basis, if on a collection basis, the fee only is charged to the customer.

A large part of the collection work consists of notes made payable at banks out of the clearing house, and at business houses, where presentment must be made to become effective, also drafts with bills of lading or other documents attached. Many of the latter are payable at a stated time, or a certain number of days after sight, or on presentation, or upon arrival of the goods. Some of these must be presented for acceptance, and some for payment, according to their tenor. A simple illustration will show the process.

COUPONS IRVING NATIONAL BANK WOOLWORTH BUILDING, NEW YORK			
Company	<u>Eni. Ry</u>	Depositor	<u>Darbo</u>
Payment Due	<u>10% 12/1</u>	10 Coupons at 25 Each	<u>2.50</u>
Payable at	<u>Sub City Bank</u>	Coupons at	Each
ENCLOSE COUPONS OF ONLY ONE COMPANY IN THIS ENVELOPE		Total Due	<u>2.50 -</u>

Form 23 —Coupon envelope

The Collection Process.

In the morning mail there is received a draft drawn upon a grain dealer for a car of oats, payable thirty days after date. In the collection register will be recorded. Maker, on whom drawn, date, time to run, maturity, from whom received, documents attached, if any, fate. It is then presented by messenger to the party drawn on, and if accepted or paid, as the case may be, note is made of the fact in the "fate" column. If payment is made the funds are remitted by the bank's draft to the bank or business house sending the same, or if from a correspondent bank, the account is credited and the correspondent is advised of the credit. If it is dishonored, it is returned, protested, unless protest is waived.

Where the item is not yet due and is *accepted*, it is held until maturity and presented for *payment*.

Arrival Drafts

Many shipments represented by bills of exchange, with bills of lading attached, are payable "upon arrival of the goods." Sometimes inspection is allowed before payment is to be made. In such cases the drawee is notified of the arrival of the bill, and when the goods arrive he must pay the draft before the bill of lading, without which he cannot obtain possession of the goods, is given him.

In the procedure built upon bills of lading, it is most important that banks follow closely the instructions of the sender. In most cases the bill of lading may be delivered only upon payment of the amount called for; and in others may be delivered upon acceptance. The risk lies in disobeying these instructions, which are often technical. Take a case in point. A bank in New York received a draft from a Chicago automobile concern, with bill of lading attached, together with a conditional bill of sale for a car. The instructions were to deliver

the bill of lading upon payment of the draft and signing the bill of sale, which retained title of the car in the sender. The bank allowed the drawee to obtain the bill of lading upon paying the amount, but did not get the signature to the bill of sale. The buyer of the car immediately placed a chattel mortgage on it and when the error was discovered the claim of the seller was superseded by the mortgage and it cost the bank a goodly sum to settle with the sender.

The Bill of Lading

These bills of lading, heretofore mentioned, are important documents and accompany all shipments of goods by rail and water. By this instrument the carrier acknowledges the receipt of the goods and agrees to deliver them to the party named, upon presentation of the bill of lading. Where the goods are sold on a C O D basis, the bill of lading is, as a rule, attached to a draft, and is deliverable to the consignee only upon payment of the bill of exchange, or draft. The title to the goods follows the bill of lading, and in many cases the goods are consigned to the seller and the bill is indorsed in blank or special, to be delivered upon payment, thus retaining title of the goods in the seller until payment has been made. The practice of carriers delivering goods without the bill of lading is almost obsolete, and the possession of the bill of lading is now *prima facie* evidence that the goods are still in the possession of the carrier awaiting delivery, according to the terms of the bill of lading.

Duns.

In the development of business, it has been found that collection of an outstanding account may be effected through the medium of a draft upon the buyer. These drafts are used in large numbers when other methods have failed. For instance, a grocer has bought

a bill of goods from a wholesale firm on open credit upon agreed terms of payment. When the credit term is over and the bill is still unpaid, the seller will write a letter of request for payment. This is ignored. Other letters follow, to no purpose. The firm then writes that it will "draw on" the grocer if payment is not made within a certain time. There follows in due course a "dunning draft" which is sent to a bank for collection. This is presented to the debtor and honored or dishonored as the case may be. Many merchants are thus forced to make payment where milder methods have failed, and many business houses make it a practice to wait until a draft is presented before making payment for their invoices. They honor the draft by writing their name across the face. The bank will then charge their account and remit to the sender, less a charge for the service.

In many cases the harmless nature of these dunning drafts is quickly discovered, and they are returned with notation "will send check," "amount wrong," etc., as a still further play for time. To such an extent have these drafts been used that many banks no longer handle them unless a fee of about 25 cents accompanies, for the reason that the great majority of them are returned unpaid, with the attendant costs in service and postage. But to the uninitiated they are yet an effective medium of collection, the implied danger being in the loss of prestige with the bank. They are in the nature of a mild threat to injure the credit of the drawee in banking circles. But the draft with bill of lading attached is a far different document, inasmuch as the buyer as a rule needs the goods and can only obtain them by paying the draft. They are dignified "C. O. D." transactions. One of the first duties of the writer many years ago was to present such drafts to the local merchants in a small city, with the results above set forth, and the observations as stated.

Collection Records.

In the place of collection registers many banks use carbon forms, making three or four copies: (a) The record of the collection; (b) advice to customer, (c) advice of receipt from sender, (d) credit ticket when paid. The open records must of course tally with the items on hand and unpaid. These collections are usually run by number, and reports made bank to bank by collection number, which immediately identifies the item.

Where the collection is in the form of a note or time draft, the timing is checked to ascertain its correctness, the essence of a time item being its presentment on the due date.

Collections with securities attached are given more careful attention, particularly in the financial centres, and are handled by experienced and trustworthy messengers, frequently retired policemen with good records.

Settlement for Collections.

Settlements for collections are made (a) By remitting to the sender in the form of the bank's draft, either on itself or its correspondent—the latter in country banks, especially; (b) by credit to the sending party, if reciprocal account is maintained, always with advice of credit. If the item is received from a customer of a bank, his account is of course credited with the proceeds.

Special Instructions.

Most collections have special instructions, either from the bank sending or the sender himself. These are "protest" or "no protest," "advise by wire," etc., although most banks have standard rules, such as to protest all items over a certain amount, say \$10, and advise non-payment of items over \$500. This applies to cash items such as checks, sight drafts, etc., as well as collections. These instructions must be observed.

COLLECTIONS
IRVING NATIONAL BANK
Woolworth Building New York

Form 24-B

DATE DEPOSITED	AMOUNT	NAME	NAME OF BANK	DATE	AMOUNT
10/2/2/	\$276	John Doe and Co	Columbia Trust	11/23	\$276 07

TO

Go on with item

Bank of Rockville Centre
Rockville Centre, L. I.

1

IRVING NATIONAL BANK
Woolworth Building New York

DATE DEPOSITED	AMOUNT	NAME	NAME OF BANK	DATE	AMOUNT
10/2/2/	\$276	John Doe and Co	Columbia Trust	11/23	\$276 07

CREDIT ACCOUNT OF

Credit ticket

Bank of Rockville Centre
Rockville Centre, L. I.

INITIALS OF	INITIALS OF
<i>JD</i>	<i>JD</i>

2

IRVING NATIONAL BANK
Woolworth Building New York

DATE DEPOSITED	AMOUNT	NAME	NAME OF BANK	DATE	AMOUNT
10/2/2/	\$276	John Doe and Co.	Columbia Trust	11/23	\$276 07

FILE UNDER DEPOSITOR

Bank of Rockville Centre
Rockville Centre, L. I.

Department record

3

Departmental Record

MESSENGER OR NOTE TELLER DEPARTMENT

When the item described upon this form is actually paid the paid stamp of the department receiving payment is to be placed herein and the form returned immediately to Collection Department.

DATE DEPOSITED	AMOUNT	NAME	NAME OF BANK	DATE	AMOUNT
10/2/2/	\$276	John Doe and Co	Columbia Trust	11/23	\$276 07

DEPOSITOR

Messengers report slip

Bank of Rockville Centre
Rockville Centre, L. I.

4

IRVING NATIONAL BANK
Woolworth Building New York

DATE DEPOSITED	AMOUNT	NAME	NAME OF BANK	DATE	AMOUNT
10/2/2/	\$276	John Doe and Co.	Columbia Trust	11/23	\$276 07

FILE UNDER DEPOSITOR

Bank of Rockville Centre
Rockville Centre, L. I.

Permanent record

5

Permanent Record

DEPOSITOR
Richard Roe and Co

IRVING NATIONAL BANK
Westmark Building New York

RECEIPT NO.	DATE PAID	DEBIT	AMOUNT	DATE	REMARKS	INSTRUCTIONS
987	10/2/21	John Doe and Co.	\$24.50	11/23	N/L	NO PROTEST

Bank of Rockville Centre,
Rockville Centre, L. I.

Goose with item

The favor of prompt cash is requested upon the line indicated by notation.
Do not hold for convenience of paper. Return to
mail only if by 11.
If the documents only upon payment unless otherwise
indicated.

IRVING NATIONAL BANK
NEW YORK

ADVISE FOR
Richard Roe and Co

IRVING NATIONAL BANK
Westmark Building New York

RECEIPT NO.	DATE PAID	DEBIT	AMOUNT	DATE	REMARKS	INSTRUCTIONS
987	10/2/21	John Doe and Co.	\$24.50	11/23	N/L	NO
COLLECTING BANK			CASH			
Bank of Rockville Centre, Rockville Centre, L. I.			Bank record			

FILE UNDER ☒ DEPOSITOR

IRVING NATIONAL BANK
Westmark Building New York

Richard Roe and Co.

RECEIPT NO.	DATE PAID	DEBIT	AMOUNT	DATE	REMARKS	INSTRUCTIONS
987	10/2/21	John Doe and Co.	\$24.50	11/23	N/L	NO
COLLECTING BANK			CASH			
Bank of Rockville Centre, Rockville Centre, L. I.			Permanent record			

Permanent Record

DEPOSITOR

IRVING NATIONAL BANK
Westmark Building New York

Richard Roe and Co.

RECEIPT NO.	DATE PAID	DEBIT	AMOUNT	DATE	REMARKS	INSTRUCTIONS
987	10/2/21	John Doe and Co.	\$24.50	11/23	N/L	NO

DEBIT

Debit slip

Bank of Rockville Centre,
Rockville Centre, L. I.

CREDIT

IRVING NATIONAL BANK
Westmark Building New York

Richard Roe and Co.

RECEIPT NO.	DATE PAID	DEBIT	AMOUNT	DATE	REMARKS	INSTRUCTIONS
987	10/2/21	John Doe and Co.	\$24.50	11/23	N/L	NO
COLLECTING BANK			CASH			
Bank of Rockville Centre, Rockville Centre, L. I.			Credit slip			

Of late there has arisen a practice to be commended, namely, the stamping on the face of the item, usually in a circle, the letters "N P" followed by the bank's transit number. This is notice to all subsequent holders that the item is not to be protested. Formerly such instructions were on the letters accompanying and much care had to be used to observe them.

The Messenger Force.

The messenger force is busy with messenger service between ten and three, before and after those hours the messengers are used about the bank in various capacities, such as in the heavy work on the mail, the care of the cash, delivery of securities, and as emergency men in training for regular duties in the bank routine.

It is obvious that in delivering notes, bills of lading, securities, etc., the bank loses its right of recourse if it allows the items to be delivered without receiving proper payment, and the rule is to require cash from parties not known to the bank, and certified checks for amounts over a certain sum, depending of course altogether upon the standing of the concern.

Where drafts not yet due are presented, they are frequently left for inspection over night, and a "left out" slip is returned showing the outstanding paper for which the bank must account. Where the proper party is not in the office and presentment cannot be made, a presentment slip is left, showing that the paper has been presented. Where such is the case, as a courtesy, the drawee is given until a certain hour to take up the item, usually until three o'clock the same day. When the messenger returns from his route, he must account for all items taken out either in cash, checks, or "left out" slips, so that all items are properly accounted for to the collection department.

The Note Teller.

It was formerly the rule in large banks to make all collections through the note teller, but as the work of the banks grew in volume, the collection of miscellaneous items such as heretofore mentioned has been taken away and the note teller now handles only the notes and acceptances of customers, together with such incidental duties as the bank may elect

This department now handles notes and other items received from customers for collection, receipt for them being given in the back of the pass book or on special receipt. The instructions of the customer are taken at this time. If the items be coupons, they are turned over to the coupon department, if an out-of-town collection, it is turned over to the country collection department, if a city collection, it goes to the city collection department. In a small bank these items would be taken in at the discount or loan window, or by the receiving teller, and would go through the work of the day according to the classification in vogue and not according to the departmental idea.

Notes and acceptances are entered in a collection register or on carbon forms, as are other collections, with details which are Date received, collection number, from whom received, amount, time, where payable, instructions and fate

Timing Notes.

It is essential that any instrument containing the element of time be presented on the day it is due, and to this end all notes and other time items are checked carefully by two persons as to the calculation of time. Notes and bills of exchange are drawn payable

(a) On a certain date.

(b) A certain number of days after date.

- (c) A certain number of months after date.
- (d) On demand, or at sight
- (e) A stated time after sight
- (f) Upon the arrival of the goods.

A note payable on a certain date is payable on that date unless the due date be Saturday, Sunday, or a holiday, when it is due on the next business day ("Negotiable Instruments Law," Section 85).

Days of grace have been abolished in all States where the Negotiable Instruments Law operates (Section 85)

A note due a certain number of days after date is due on the last day of the time mentioned, unless the due date be Saturday, Sunday or a holiday as above noted. In computing the time exclude the day of date and include the day of payment ("Negotiable Instruments Law," Section 86).

A note due a certain number of *months* after date is due on the same day of the month indicated, Saturdays and Sundays and holidays excepted as above noted.

A note due on demand *may* at the option of the holder be presented on Saturday before 12 o'clock where Saturday is a half holiday ("Negotiable Instruments Law," Section 85)

An instrument payable at a bank is equivalent to an order on the bank to pay the same for the account of the principal debtor thereon ("Negotiable Instruments Law," Section 87)

Notes payable on demand or at sight should be presented for payment within a reasonable time, and what is reasonable time depends upon circumstances ("Negotiable Instruments Law," Section 71) For the full law in respect to presentment, see "*Presentment for Payment*" ("Negotiable Instruments Law," Sections 70-88).

Collection Records.

Some banks keep a note tickler or blotter in which

Bank of Rockville Centre,
Rockville Centre, L. I.

DATE	PAYEE	AMOUNT	WHERE PAYABLE	DUE	ENDORSE
10/8/21	John Doe and Co.	\$15.70	Met. Park Bank	11/5	R. Roe and Co.

Does with item

PROTEST *if not paid*

THE PATENT OF INQUIRY RETURN IS REQUESTED FROM THE ITEM HERewith ENCLOSED FOR COLLECTION.



SUBSEQUENTLY IRVING NATIONAL BANK

Branch: 10 Bank, New York City

Bank of Rockville Centre,
Rockville Centre, L. I.

DATE	PAYEE	AMOUNT	WHERE PAYABLE	DUE	ENDORSE
10/8/21	John Doe and Co.	\$15.70	Met. Park Bank	11/5	R. Roe and Co.

Advice of receipt by collecting bank

Does not request and return A. advice _____ SP

End of _____

PLEASE SIGN AND RETURN BY FIRST MAIL To Irving National Bank

100 Wall St. New York City

Bank of Rockville Centre,
Rockville Centre, L. I.

DATE	PAYEE	AMOUNT	WHERE PAYABLE	DUE	ENDORSE
10/8/21	John Doe and Co.	\$15.70	Met. Park Bank	11/5	R. Roe and Co.

Credit ticket

Date Advised Paid

CREDIT BILLS DISCOUNTED

DEBIT
Bank of Rockville Centre,
Rockville Centre, L. I.

DATE	PAYEE	AMOUNT	WHERE PAYABLE	DUE	ENDORSE
10/8/21	John Doe and Co.	\$15.70	Met. Park Bank	11/5	R. Roe and Co.

Debit ticket

Bank of Rockville Centre,
Rockville Centre, L. I.

DATE	PAYEE	AMOUNT	WHERE PAYABLE	DUE	ENDORSE
10/8/21	John Doe and Co.	\$15.70	Met. Park Bank	11/5	R. Roe and Co.

Tracing slip

Tracing Slip

FORM 26—Collection forms Original and four carbons

are recorded all items received for collection. This is followed by carbon copies which give the details of the transaction. One copy goes to the owner as advice of credit when the collection is made, one to the bookkeeper as a credit ticket, and two copies are attached to the item. The third copy ultimately goes to the "owner's file," which assembles all the tickets that pertain to a customer's account. This file traces items upon inquiry for the customer and also indicates the volume of business received from him, and in case of overdrafts, the outstanding credits to offset. The fourth copy goes into a file for makers and acceptors as the one primarily obligated on the instrument. These records enable the bank to inform makers and acceptors as to the amount held by the bank for future payment. These slips are kept a considerable length of time for record purposes.

The items are further classified according to due dates, so that all items needing attention on a certain day will be in one place. This enables the bank to make prompt collections and to protest such as are not paid on the day due. It is generally called the "maturity tickler" and may be either a bound book or loose card records.

The instruments are then filed in note files according to their due date. In the larger banks the notes are divided into notes falling due in the city and out-of-town items.

Notes payable out of town are recorded in the same manner as local items, and are sent out about ten days before maturity so that they will be at the place of payment on the day due.

The notes falling due on the following day are prepared for presentation the day before, the runners' lists being made up and checked with the records, presented in due course by the messengers and returns made to the note teller.

In a small bank the foregoing work may be performed

by a clerk at odd times during the day To revert again to personal recollections It was one of the duties of a fellow clerk each morning to take out all notes, drafts, and checks on the local banks which were due that day, and present them for payment either at the banks where payable or at the place of business of the party drawn on, and the "collection department" of the bank did its work in about an hour But in substance the one clerk did all that the collection department of a large bank does, and in many banks today the same procedure is in effect.

Notes and acceptances payable at the bank itself are treated as debit items and charged to the maker the same as a check would be, usually with the initials "D. M." (*debit memorandum*) on the account to indicate that it is not the depositor's check These debit items appear in the vouchers when the account is balanced, in the form either of the instrument or of a proper ticket.

Notes Payable Through the Clearing House.

Notes and acceptances payable through the clearing house are presented to the bank where payable on the morning of their due date, and if funds are in hand, they are certified or accepted and presented through the clearing house the next day with the checks, if dishonored, they are generally presented again during the day

Settlements for items collected are made either by cashier's check or by credit to the customer, using the carbon form of notice of payment, mentioned above Where the item is dishonored, it is returned with the bill for protest fees, if such there be

Aside from collection of notes and acceptances, the note teller also handles such cases as delivery of papers, deeds, mortgages, stocks and bonds against payment or

other conditions, and some aggressive banks even go so far as to buy railroad and theater tickets, secure state-rooms on ocean steamers and sundry other services for their clients as a process of building up good will

In some banks the note teller collects exchange charges from customers who prefer to pay in cash rather than by a charge against their account. The calculations are made in the transit department and turned over to the note teller to collect, each keeping a control over the other.

Exchange Charges on Collections.

Inasmuch as the collection of notes, bills of exchange and such other instruments as are handled in the collection and note teller's department, involves special services and more ceremony than checks, a service fee is generally charged in the form of exchange. The collection of coupons is generally gratis to the customer, and the charge for exchange on collections is usually discretionary with the bank.

Coupons.

All banks receive coupons for collection, and especially so since the advent of the Liberty Bonds. In the great New York banks the work of collecting coupons is particularly heavy, inasmuch as most of the large corporations and railroads have made their coupons payable at their "fiscal agency in New York," which is either a bank or trust company. It therefore follows that when the exact place of payment is not mentioned in the coupon, or has been changed, the bank must know where these items must be presented. The New York banks thus become the collecting agents for coupons received from all parts of the country. These instruments being payable to bearer are equivalent to cash, and are given the same care as cash itself. In addition there are maturing bonds, which are treated in the same manner as coupons.

Many banks also have departments that care for customers' securities and from these the coupons must be cut and collected when due. There are also the coupons from bonds held as collateral to loans as well as the coupons from bonds held as investment, and these too must have attention as they fall due. To summarize, coupons are received from the following sources:

- Customers and clients of the bank for collection and credit,
- Bonds in safekeeping,
- Bonds in loans,
- Bonds held as investment,
- Bonds from trusts

Coupons handled for collection are given the same treatment as other collections, recording the name of the paying corporation, owner, due date, class of bonds, number and amount. The coupons are enclosed in specially prepared envelopes giving the name of the company, owner, due date, number and amount. When sent through the mails they are always registered and insured. Since the introduction of the income tax, all coupons with the exception of those from United States obligations and other bonds that are exempt, such as municipal securities, must be accompanied by income tax certificates which conform to the requirements of the Treasury Department. These are prepared by the owner, or by his agent, and are essential to a coupon collection. All banks have such forms.

CHAPTER XII

CREDIT AND CREDIT INFORMATION

In approaching the subject of credit, we approach the very heart of the bank, for through this element the bank functions. It is a wonderfully fascinating subject—the most interesting of all the phases of business. It involves psychology, law, finance, merchandising methods, economics, and the rules and usages of business. Whom to trust has been the problem of business since men began to trade, and the science of credit decides this question. The art of banking consists in lending money and getting it back again. And it is an art, learned by few in its completeness, yet practiced by all in its incompleteness.

Credit a Broad Subject.

If the subject of credit were to be discussed from its every angle, it would require a volume in itself to treat of the many ways in which this element enters into banking transactions. Every check that is drawn and paid represents the birth and death of a credit transaction. Every promissory note and every bill of exchange is merely a credit operation. Every deposit made in the bank, every collection made by the bank, most of the money issued by the bank are forms of credit. Most of its assets are represented by credit instruments in one form or another, and underneath all is the element of *credo*—belief.

Banking from start to finish, from the days of the Bank of Amsterdam to the days of the Federal Reserve System, has been but a system of credit applied to human wants.

The Three Big "C's" of Credit.

Every loan that enters the bank must be examined from three viewpoints the moral risk, the business risk and the property risk, or, as I have in other places put it, the three "Big C's of Credit" must be in evidence and in satisfactory proportions, else the element of risk enters unduly. These are, Character, Capacity and Capital.

J Pierpont Morgan has often been quoted as saying, in substance, that he would trust a man who he knew had *character* to the limit of his requirements, while he would not lend a man without character even on collateral. Now what is business character? It is best expressed in the word *integrity*, which has a better ring. Business character is a plant of slow growth, built up by years of fair dealing, honest advertising and unquestioned methods. It does not mean that a man shall be good—he must be good for something. His virtues must be positive and not negative. He must live in the realm of "I do" rather than "I do not."

During the week this chapter was written, the writer attended a sale of a quarter million of bonds issued by a school district. There were but two bids, one by a bank and the other by a bond house. The bank's bid was lower by about \$2,500 than that of the bond house, and yet the board of education awarded the bonds to the lowest and not the highest bidder, as usually is the case. And why? For the simple reason that the bond house previously had endeavored to play a trick upon them and had lost their confidence and respect. Its character so far as that board was concerned was gone. It had lost caste.

There are business houses, and banks, and merchants, big and little, whose names are synonymous with integrity. Every article that comes from their hands is exactly as represented. If it be a "second," it is not

sold as a "first." If it is not satisfactory, it may be exchanged. No subterfuge is ever used to make a sale, nor is camouflage in the dictionary of the man to whom honor is a sacred thing.

The Nation's Honor.

We have had a test of the nation's honor, as represented by the merchant and jobber, during the year 1920. When the price wave reached its crest and values began to tumble, merchants and jobbers the country over began to cancel their contracts. While prices were going up, they demanded that their goods be shipped, when prices began to fall, they ordered shipments stopped. What cared they for honor, or the solvency of the firm that had accepted orders in good faith, and perhaps made to order the goods desired? The activity of business was transferred to the courts in settling claims for damages due to cancelled orders. If you profit by a shipment—demand it on scheduled time, if you lose—send it back! But a moral breakdown among the merchants of a country that clogs the courts with damage suits is a severe indictment of a nation's business morality. And in this a nation indicts itself.

There can be no safe credit where character is lacking, for honesty is not only the best policy, it is the only policy that ever makes for permanent prosperity. All other methods lead to disaster, moral and financial.

This character test is not easy to make, for what one man would consider ethical and proper another might not. It depends upon the viewpoint of the one making the analysis. Some men whose character from a moral viewpoint might be questionable are of high order in so far as business practices go. They may have a high standard of business ethics and a low standard of moral con-

duct Some gamblers are men of the highest business morality as regards their business obligations Their word is better than their bond But it is agreed by all students of credit that the element of character, as determined by a man's personal, family, business and social life, is absolutely essential to any sound business risk which involves money and the performance of contracts, verbal or written.

The Business Risk

What a man has done he is likely to do again History repeats itself both in the case of individuals and nations Past performances forecast future achievements Therefore the second test of sound credit is the record of the borrower If, for instance, a young man has gone into business, with little capital, and by diligence, economy and integrity has built up a profitable concern and become established, it follows that he must have had that second big C of credit—Capacity The life history of the successful men of today follows the same general line, and shows that character plus ability spells success The men of achievement are those who have won out against great odds through sheer merit, but unless ability be balanced by integrity there is always the danger that the ability may be used to defraud A clever man may be clever in the wrong direction The great pity is that so many men of inherent shrewdness and marked business talents do not use their ability for constructive purposes A simple illustration comes to mind

One day the writer was called on the telephone by a New York tire company and asked to vouch for the integrity of an individual who desired a line of credit of \$10,000 for automobile tires, which he wished to purchase. This fellow had no visible means of support but his wits. He had no property He had formerly bought

several car loads of lumber and sold it below the market, and given in payment notes signed by himself which were never paid. Then he went into illicit liquor selling. When New York got "too warm for him" he went to Florida and operated in land for a few months. Coming back to New York, he went into the tire business and began selling tires at retail at prices far below the wholesale rates. It looked as if the tires were either stolen or obtained by false representation. At any rate, he made deliveries and got the tires to fill his orders. In checking up these transactions, it developed that before opening his credits, the tire dealers had asked for and received references, which were eminently satisfactory both to them and to the banks consulted. But he had given only those concerns whose experiences had been favorable. On these advices one firm had given him nearly \$10,000 worth of tires which he had sold for cash at prices which would move them quickly. In payment he gave "trade acceptances"—in reality promissory notes. Before they became due, he had sold the tires for cash and disappeared. There can be no question of this man's ability, and part of his record was good. He lacked the essential element of honor, but had a surplus of ability. He was not evenly balanced. And there are thousands of similar cases where ability has been used to swindle the trusting business public, which can hardly safeguard itself against such practices. In such cases there remains one safeguard, which is the third element of sound credit—the Property Risk, or Capital.

Capital.

Had the foregoing individual been possessed of property, the debt might have been collectable out of his property, but having none the law offers no redress. He had committed no crime in its sight.

Therefore, before credit can be called safe, we must not only have good character and ability, but property. In case the credit risk becomes doubtful because of lack of integrity, and in the event that the business risks have brought on a condition of danger, we must have something tangible to fall back upon.

The man of character may be a novice in business, unacquainted with the art of making money, and therefore dangerous though fundamentally honest. The most pitiful thing in business life is the man who is merely honest. He gets nowhere if that be his only asset. The world is full of financial wrecks who never did a wrong. Their virtue got them nothing but character. And the man of ability may be a crook, as many men of fine intellect are. But having a proper mixture of ability and integrity, plus property, to safeguard against the risks of business, we have the perfect credit setting. Therefore banks and business houses want to know how a man stands as to his property before they will assume the risk of selling or loaning on credit. In other words, if he does not pay, can he be compelled to pay? Has he tangible property to make a judgment good? Has his ability and his honesty resulted in property worth—and of what does that property consist? This is evidenced by his statement. To show how the various elements above mentioned enter into consideration let us review a credit application that was somewhat unusual. A was a traveling salesman for a western house, selling on commission. He approached his banker one day and asked to have a note for \$1,000, given by his firm for commissions due, discounted. These commissions were earned in the summer of 1920, and the note was given in October of the same year. The firm had received payment for the goods sold. A checking of this firm showed them to be lacking capital. They were short of funds.

The statement which the applicant offered showed it and the banks consulted confirmed it. The note itself was evidence of it. The borrower was asked for his own statement. It showed that he was heir to his father's fur business, then in a very precarious condition, also he was beneficiary under will, and would own a house and lot as soon as his father's estate was settled. He also owned two automobiles, one for business and the other for his wife's pleasure. His income had been around \$5,000, and the discount desired was for the purpose of paying current bills which he had contracted about town. The loan was promptly and properly rejected. From every angle this was a bad credit risk, having no redeeming features. The two automobiles were enough to discredit the whole transaction, since they showed lack of judgment and a tendency to live beyond his means.

The Statement.

Of recent years the filing of a statement as a condition of borrowing has become almost universal among banks. Credit information is no longer a matter of hearsay or snap judgment, but of actual fact. Even in the smaller banks, statements are required in order that definite information as to the borrower's condition may be known, and all banks have forms for this purpose. The moral risk and the history of past achievement cannot be set to writing unless the record of the borrower is investigated for this purpose, and to this end commercial credit agencies, such as Dun's, Bradstreet's, and Proudfoot's, give a history of each firm reported on, together with its record in the business world. In small places this of course is a matter of common knowledge, and is the unwritten history of men who have made good.

In preparing a statement, and in the examination thereof, it is helpful to set down the basic facts first,

and in uniform arrangement. Therefore we list first the quick assets and the quick liabilities. The quick assets consist of:

Cash on hand and in banks
Accounts receivable—good
Notes receivable—good
Merchandise
Stocks and bonds

The quick liabilities consist of

Accounts payable
Notes payable

Cash of course needs little comment. It is really cash or accounts in banks due on demand, and nothing else.

Notes receivable are obligations taken for goods sold, and are found in quantities in but few lines of business, but since the advent of the "trade acceptance," discussed hereinafter, these instruments are to be found in growing amounts in many lines of business and rightfully so. They take the place of accounts receivable and are a much better form of asset, but to discuss them further here would be repetition. Merchandise is goods on hand, raw material, or raw material in process. To discuss fully inventories and the proper methods of appraisal would consume more space than this work allows, and reference is made to my other works, which treat more extensively of this topic. Suffice it here to make a few observations.

The Havoc of the War

In the deflation that followed the drastic inflation of the war, merchandise has suffered most keenly. The merchant who was rich in 1920 was poor in 1921, because his goods on hand could not be sold for the amount paid for them.

During the war period, anyone having merchandise needed but to hold it to see his profits roll up. He could sit in his front door and grow in riches though doing nothing but mark time. Anything he had was worth more than he paid for it. In many cases he could get his own price, and in some instances he could not replace his stock at any price. He was in a rising market. The yard of cotton goods that cost him eight cents would sell for 40 cents and could not be bought for less than 35 cents. Everything men used went up and up and up. And then the bubble burst.

The Strike of the Buyers.

The public stopped buying in the spring of 1920, and prices began to recede. The buyers were on strike against high prices. The big department stores all over the country announced drastic cuts in all lines in order to stimulate buying, but the stimulus was temporary. Men wore their old shoes and old clothes. They did without rather than pay the price exacted. Everybody was doing the same thing, except the few profiteers who had made fortunes out of the war. But these were in the minority. The patriotic man did not get rich out of the war. The great majority suffered in purse because of it. As late as April, 1921, the Federal Reserve Bank of New York reported that the buyers were still on strike.

I talked one day in the spring of 1921 with a cotton merchant in New York. He said that in 1920 he was worth about \$200,000. A year later he was worth less than \$50,000. I asked him the reason, and he said he had stocked up in 1920. His profits had gone into goods, and he was "goods rich." Along in April, 1920, he noticed a falling off in orders. His friends and salesmen assured him that it was but temporary and advised him not to sell, but to hold on. He did.

Whereas in January, 1920, he sold about \$100,000 worth, in January, 1921, his orders were less than \$10,000. His stock became less and less valuable as time went on, and he could sit in his front door and see his wealth go out while he was helpless to prevent it. He was caught in a falling market, as many were, and escaped bankruptcy only by a bare margin.

The merchant who bought sugar, or clothing, or shoes, or what not, in the rising market, for profits, took losses instead, and thousands felt the blighting hand of depression. Even the great mail order houses with their vast organizations, their shrewd business ability, their brains and their foresight were helpless. Goods could not be moved, and what they sold did not bring back the original investment.

The Inventory.

It is readily apparent that in such a condition only one course remains to mark down the merchandise to meet current conditions. And the great problem of 1921 in analyzing a statement was to determine if the inventory was taken at replacement values. Therefore in examining a statement at any time we must consider carefully whether the merchandise item is conservatively stated.

The general rule in making inventory is. Cost, if the market is above cost, and market value, if the cost was above the replacement value. That is, if a stock of goods cost \$10,000 and can be sold at that figure plus the usual margin of profit, we may allow cost, but if the goods can be replaced for \$5,000, then \$5,000 is a proper figure.

The integrity of the merchant comes into play here. If he is inclined to be tricky, he will misstate his inventory, and thus inflate his worth. And only as he is honest to the degree that hurts, can his statement be

relied upon I would give inventory at all times first consideration. The story is told of a New York merchant who, upon drawing up a statement for the purpose of obtaining credit, locked his bookkeeper in a room and told him not to come out until he had juggled his inventory figures so that a net worth of a certain amount could be shown. And only a revaluation of every item and an examination of the extensions would uncover a fraud of this kind. The man's ability had been used to defraud. We must know the basis of the inventory, else we work in the dark.

Accounts Receivable.

We turn next to the accounts receivable. These are book accounts for goods sold. They represent merchandise gone out of stock. And having been good merchandise, good money must come back, else we have given them away, or traded them for lawsuits and legal processes, which are slow and costly. These may be classed into Accounts not yet due, accounts due and unpaid, accounts slow, and accounts doubtful. It is the usual practice to state these in full with allowance for inevitable depreciation in making such collections.

The last item is the stocks and bonds. These may be, as obtains in many cases, Liberty bonds, and therefore easily appraised. Likewise in the case of listed securities, but if they are of subsidiary concerns, interlocking with the parent concern, only inside information will reveal the soundness of these values. Such investments are not common in financial statements.

If the audit is made by a recognized firm of public accountants, they will state the basis of inventory and the quality of the other assets.

Having the total of the firm's available quick assets, we know how much there is in potentiality for the pay-

ment of the debts; for quick liabilities can only be met from quick resources.

Quick Liabilities.

The quick liabilities consist of, (a) Accounts payable These are for goods bought and delivered. They mature constantly and all good firms pay promptly in order to take advantage of the trade discounts mentioned hereinafter They can be met only from the inflow of cash from merchandise sold for cash, and accounts receivable paid when due There follows, (b) The notes payable These are for goods bought and settled for by notes or acceptances and bank loans, and likewise falling due constantly

We now have the basis for determining the *ratio* of quick assets to quick liabilities, which as a rule should be 2 to 1, or, in other words, for every dollar of obligations due or becoming due against the firm, there should be two dollars due or coming due to the firm If, therefore, the assets realize but fifty cents on the dollar, the firm can pay in full and the creditors will be protected It follows conversely that a vast shrinkage in the value of merchandise or a poor line of accounts receivable will jeopardize the interests of the creditors

In some lines, such as meats and groceries, where there is a quick turnover of stock, and depreciation is not so likely as in goods that move more slowly, the ratio safely may be less. In the lines mentioned, one and a half to one might be sufficient, and two to one would be amply safe, provided of course the inventory was conservatively stated

The other assets, such as land and buildings, patents, good will, machinery and fixtures, delivery equipment, etc., need not be discussed here, since they are adequately covered in my other works,¹ as are the fixed liabilities,

¹ "Commercial Paper and the Analysis of Credit Statements," "The Practical Work of a Bank"

such as capital stock, surplus, mortgages, etc., that offset the same items.

In analyzing a credit statement for the purpose of lending, particular stress is laid upon the quick assets and liabilities, inasmuch as the borrower's liquid condition is therein set forth. But for more detailed information concerning him, the volume of sales, turnover, profits, value of land and buildings, machinery, good will, and maturing mortgages, bond and stock issues are examined to get a true picture of the business as a whole. This process opens up a most interesting and profitable field of inquiry that may well be followed by the student who wishes to pursue the study of credit further.

The Credit Department.

The credit department of a bank is a department of information and not a department of credit extension. It assembles information but does not use it, and to state what should go into a well-organized credit department would be equivalent to undertaking to describe what should go into an encyclopedia.

The credit department has its chief, its files, assistants and the credit investigators. For every borrower, and in some banks for a large number of merchants and others who are not customers of the bank, it has a file. One New York bank has over 350,000 names in its credit files.

Sources of Credit Information.

1 *Banks* Inasmuch as the local bank—the bank that carries the customer's account—is more conversant with his affairs than any other agency, it forms a chief medium for credit information. Letters from banks and business houses are received daily making inquiry as to the standing of certain firms, and banks exchange such information very freely. In many cases the information

is given orally to credit investigators representing banks and credit reporting agencies

2. *Trade channels.* It is customary to check a borrower not only through his bank or banks, but also through the channels of trade in his particular line. The firms that have dealt with him know of his habits of pay, whether he takes discounts or not, and their general experience with the name. They too exchange credit information freely.

3. *The statement as the borrower's credentials.* In the granting of loans, banks large and small require a statement of the borrower as before stated. This, if made periodically, will show his progress and the many facts that may be deduced from a credit statement, and it is surprising how much information can be gleaned from a close analysis of a credit statement.

4. *The press.* The credit department of a large bank will have a well-organized press-clipping force which gleans from the press, daily and otherwise, trade papers, etc., information about firms and corporations which forms part of the credit files. Particularly is this true of judgments, lawsuits, deeds, mortgages, etc., compiled from public records and published in the specialized papers.

The commercial paper brokers have extensive information about each firm whose paper they handle, and this information is freely given the banks who purchase the paper.

5. *Lastly the bank's own experience with the name.* This will include the average balance, borrowings, overdrafts, profitableness of the account, etc., and any other information that may accrue from the connection of bank and customer.

Correspondence regarding the credit standing of the name is filed with the other matter, so that in one place

the bank has a complete record of all its findings that center around that name

The credit department answers inquiries regarding these names, and copies of the letters are filed with the other information for future guidance. When an inquiry comes in from a correspondent concerning any individual or firm not in the files, an investigator is set to work to find out the full history of the one inquired about, and it is quite surprising how much a good credit investigator will discover concerning such a name in a short time.

As records of judgments are filed in the seat of records, they are reported and listed, and if the name appears as a borrower, the effect upon his credit standing is at once looked into. Likewise in the case of transfers of property. The deeding over of a property to the wife is often the first sign of danger ahead and is so looked upon in banking circles. The credit department is really a detective bureau, with a keen scent for trouble ahead.

When a bank receives an inquiry in regard to the purchase of commercial paper, the credit department makes answer, using the files as the basis of the facts stated.

The larger banks have officers in charge of the credits in a certain territory, and these men pass upon all loans to the borrowers in their jurisdiction. Other banks have officers who are conversant with the various lines of merchandising, and follow their peculiar line as a specialty. They specialize and necessarily so. One man could not know it all.

When an inquiry or an application for a loan comes in, the facts are assembled by the credit department for use in the loan department, which it supplements. The work of the credit department therefore has an especial fitness for official position, and from it graduate many of the bank officers whose work requires a knowledge of credits.

Composition of a Credit File.

A well-organized credit department will have a file for each name with provision for information arranged as follows. (a) *The general summary, or "fly sheet"* This contains a history of the account, when opened and by whom, name and address of the firm, officers or firm members, banks that have the account; brokers that handle the paper, affiliated concerns and line of credit granted. Some banks also file with this summary the original offering tickets.

(b) *Statement* This includes the statements furnished by the borrower and a general summary or analysis made by the bank. Banks prefer those statements made on their own forms, by public accountants of known standing. The basic facts are taken on a comparative sheet, which shows the changes in the various items from time to time and other facts, such as ratios, etc., that the bank may decide upon. The latter will include sales, percentages of quick assets to quick liabilities, net worth, turnover, and profits.

(c) *Information* This is of general character, reports, clippings, transcripts of interviews with the bank's representatives, etc.

(d) *Inquiry.* This includes the letters of inquiry on the name, and the answers thereto. Upon receipt of an inquiry concerning a name, a letter is prepared, which will form the basis of any future inquiries on the same name, making a second investigation unnecessary. It also shows who have made inquiry on the name.

(e) *Credit agency reports* These are the reports of Dun's and Bradstreet's agencies, and are kept as a separate part of the credit folder on the subject.

The credit files are kept up to date by constant revision and supervision. A card index is maintained which follows up each borrower and keeps the information

fresh A revision is made at least once a year, and if any unfavorable information is received an immediate checking is begun. This information is freely given to customers and correspondents of the bank, using a letter head with notation somewhat as follows

This information is given in confidence and in reply to your inquiry. The information is given as a courtesy only and is a mere expression of opinion, and neither this bank nor any of its officers assumes any liability or responsibility in connection therewith.

Commercial Paper Checkings.

Inasmuch as the city banks are large buyers of commercial paper, both for themselves and their correspondents, these files are of great value in passing upon such purchases. Where the bank purchasing the paper does so upon its own checking, it depends upon the city banks for such credit checking as it chooses to make. This consists of a letter of inquiry and the answer, which forms part of the credit files above noted.

Such a letter usually reviews the experience of the bank with the name, the amount of credit granted, line of deposit maintained, and sometimes a digest of the statement. In many instances reference to names is made by initials, and in some cases by no mention of name at all, being "in response to your inquiry of the
"

Purpose of Credit Information.

No department of banking has made more rapid strides than the credit department, which is scarcely twenty-five years old. In the development of banking and business as a twofold interlocking partnership, it was found necessary to have more complete information about borrowers than theretofore obtained. The banker of olden days knew his man, his methods and something

about his business, but much of this information was inexact, and as the volume of banking transactions grew apace, it became necessary to have more and detailed information about each borrower. Therefore the credit department came into being, to supply the officers and lending committees with full and complete data on all names submitted to them.

As the banks began to widen their sphere of operation and take in firms from various other places, the personal contact and intimate knowledge of the firm's affairs could not be had, and in its stead we now have the credit files, impartial, impersonal, complete.

The use of these files is of course for the purpose of making loans. They assist the officials in arriving at conclusions regarding lines of credit. They furnish facts from which the loaning officers draw conclusions. The credit man as a rule does not pass on credits; he gathers the information for the other men to use.

Course of a Loan.

The beginning of a loan or line of credit is an application blank giving the name, address, kind of business and amount desired. If the bank is a departmental bank, the ticket will go to the various departments where loans are handled, and thereon will be stated the existing amount of loans and discounts, if any, past loans granted, average balances, present balance, etc. If the bank is a small one, the same information will be gathered from the various books, although the latter banks do not keep so complete a statistical record of their customers' affairs as obtains in the larger ones.

Loans are granted either upon an individual examination of each offering, when every separate request means a review of the basic facts concerning the borrower, or by the extension of a given line of credit, which means that

the borrower can at any time procure loans and discounts up to the limit fixed, without other formality than offering the necessary papers and documents to the lending officers for their perusal and acceptance. Frequently the line is granted upon "acceptable paper being offered," in which case the notes and bills constituting the line of credit are also investigated through banks and other media.

CHAPTER XIII

LOANS

It is the business of a bank to lend money. Discounting is one of its fundamental functions. By this it lives, pays expenses and creates dividends for the stockholders and interest for the depositors. It deals in but one thing—credit—using money as the basis of the credit structure.

It has been found by long years of experience that a dollar in money will support several dollars in credit, just how many dollars in credit depends upon conditions and the velocity of the turnover. Banking is built upon the proposition that out of a hundred men who are depositors in a bank, only a certain number will want their money at any one time. That is to say, if ten men deposit a thousand dollars each, the bank may safely conclude that if it keeps \$2,500 in cash or quickly available, it can meet all the ordinary demands of the ten men. Some will deposit while others withdraw. Even though some withdraw all, others will draw nothing. And so the bank works on the rule of this experience and lends or invests all but a minor portion of the deposits left with it. Take an actual example. Here is a bank with \$2,000,000 in deposits. It knows from experience that if it keeps \$50,000 in money in the vaults and \$100,000 in New York banks subject to check or call, it can meet all its regular demands. Therefore it can invest a portion of the \$1,850,000 in bonds and a portion in collateral loans subject to call and a part in discounts for its customers. For otherwise it could

not operate profitably, nor pay interest on its deposits. Only as it earns money can it pay money.

If at any time the depositors become suspicious that all is not well with the bank, and demand their money faster than experience teaches is the rule, we have a bank run—which is nothing more than a state of mind in which many men come to the same conclusion, but as long as the public trusts the bank, it can function and carry on its loan operations in safety.

In fact, a large part of the bank work consists in making, recording and caring for the loans. It necessitates executives to make and collect them, and it requires clerical help to record properly the many details that attend the loan function.

The Bank Carries the Load

In an analysis of banking operations, it will be found most interesting and helpful to consider the bank as a bridge that spans the time from one process to another. It carries the load from seedtime to harvest. It exchanges funds for future promises. It lives by faith. The farmer who needs funds to purchase seed and fertilizer, and to pay for labor to put in his crop, gives the bank his note, and receives money or credit funds, with which he makes payment. When the crop is matured and marketed, he receives funds in return with which to cancel his debt to the bank. The merchant who needs goods for seasonal sales borrows from the bank and makes his purchases. By the time his note matures, he has sold the goods for funds, and with these he liquidates his debt to the bank. The manufacturer who needs raw material for manufacturing purposes borrows from the bank, buys the raw supplies, turns them into finished products, sells, and with the proceeds reimburses the bank.

The reason the bank can lend is the fact that it deals with many people. Some have funds which are idle and some need funds. Through the medium of the bank, the man who has funds to spare meets the man who is in need and the one lends to the other. The bank, in substance, guarantees the loan. Those who need capital may have it, and those who desire income from capital already accumulated receive compensation in the form of interest.

Were it not for this mixture of surplus and dearth, the bank could not operate. And aside from the checking function, it is questionable if the bank, in any of its services, renders a more valuable aid to the business interests than in its loans. It gathers up the idle funds of the community and places them at the disposal of the trading and manufacturing element to the profit of both. It supplies the man who needs capital and can furnish the necessary qualifications with it at little cost. It "carries the load" of business.

Loans and Discounts Distinguished.

The term "discount" is used to describe a promissory note, or bill of exchange, the property of a customer, or the customer's own note, maturing at a future time, against which the bank has advanced funds. In other words, the bank has anticipated its payment for a consideration, which is called the "discount." Discounts are distinguished from loans in that the interest on a discount is collected in advance, while on a loan it is collected at stated times, or when the loan is paid. The latter is usually payable on demand. Thus, if a bank were to discount a note of \$5,000 running four months at 6 per cent., it would deduct \$100 and credit the customer \$4,900 and carry the \$100 immediately to interest or discount account, but if it were to advance him \$5,000

\$1000.⁰⁰ New York Sept. 5 1921

Three months after date I promise to pay to
the order of Richard Roers

One thousand ————— Dollars

at **IRVING NATIONAL BANK** 
 WOOLWORTH BUILDING

Value received

No. 27 Due Dec 5/21 John Doe & Co

Form 27 — Promissory note

at 6 per cent. for four months on a loan basis, he would pay \$5,100 at maturity. In reality the bank charges interest on \$5,000 and parts with only \$4,900, but this in law is not a usurious transaction. Generally speaking, discounts are made on the general credit of the maker and his indorsers, while loans are made on security such as stocks and bonds, etc., commonly called *collateral*.

In most cases borrowers are given standing lines of credit, so that a consideration of each note offered is not given, leaving it to the clerks to keep the borrower within the limits.

Inasmuch as the function of the bank is to discount negotiable instruments, and because of the fact that the bank profits from its loans, and would not long continue to fulfill its mission in the business world if it did not loan, this is one of the most important of the bank's many-sided activities.

It is quite the common custom for banks to lend to customers in preference to others, and a satisfactory deposit account is the first step toward satisfactory loans. There is a double profit in this respect, for the bank charges interest on the full amount, while part of it may be on deposit without interest.

We are not here concerned with the mental process that precedes the granting of the loan, that being treated under the subject of bank credit. We discuss here simply the mechanical side of the loans. The process briefly stated consists in (a) the application for the loan, usually to an executive of the bank. At this time the borrower's statement will be taken, and the purpose of the loan stated, (b) its submission to the discount or loan committee, (c) the preparation of the note and its proper signing, (d) timing; (e) discount calculation, (f) credit to depositor, (g) entry into discount record; (h) entry into maturity book, (i) entry into liability

book, (j) filing in note cases. Let us follow in the same order. Applications for loans are received on "offering slips" or in an offering book. When the matter appears before the committee, it is accompanied by the borrower's statement, together with the findings of the credit department and such other information as it may have assembled relating to the borrower. The average balance carried in the account is also stated, together with the present line of discounts, both direct and indirect. The action of the committee is recorded on the minute book of the committee, which meets daily, weekly or monthly. Right here it may be permissible to digress for a moment and discuss committees and committees.

The Master Mind.

I find that in most banks there is a master mind. It may be the president, or it may be a humble director who has not the dignity of an office, yet rules the day. Committees are appointed as a matter of course, but the master mind rules. It is my belief that a bank should be run by executives who know banking, are paid well for knowing banking and are given certain rights and duties. If a man is fit to hold his job, he is fit to be given and to assume responsibility. If he will not assume the cares of his office, he has no right to its compensation. If he cannot make decisions, let him hire some one who can.

The true function of the committee is advisory. At times the individual needs the combined advice of many minds reaching an agreement, and at such times the committee truly functions. But to hold over every proposition requiring attention until a committee can meet and discuss it retards the work of the bank, badly cripples the executive officers and breaks down the good will. In fact, it is most embarrassing, to say the

least, to an executive to be restricted by rules and regulations, laid down by a committee, that cannot and ought not to be followed. The true executive makes mistakes, but only one of the same kind. He takes losses as incidental to business. He is right 90 per cent of the time and the other tenth does not matter.

Borrower Should Keep Compensating Balance.

Inasmuch as the law fixes a limit to the borrowing capacity of individuals and firms, they must not be allowed to exceed it. And since banks generally loan principally to their depositors, the status of the account is the guide to determine what kind of a depositor he is.

There is an unwritten law in banking that the borrower should keep on deposit one-quarter or thereabouts of the amount borrowed, or, in other words, the ratio of deposits to loans should be one to four. That is *not* to say that one who deposits a hundred dollars can borrow four hundred, but if he borrows four hundred he should keep a balance of one hundred. The reasons for this are (a) It builds up the deposits of the bank—and all banks endeavor to show a large line of deposits; (b) it keeps the borrower in working funds, and incidentally gives the bank a larger profit, for the borrower really has the use of but part of his loans, while he pays interest on the whole. It is a banking secret. Having these facts before it, and a knowledge of the man himself from a moral standpoint, the committee acts.

Interest Calculations.

Timing the note follows the rules laid down on page 140 under collections, and need not be repeated.

In calculating discount the bank figures interest for the full number of days the note has to run. Where the note carries interest, the interest is added to the face of the note and the full amount is discounted,

Banks have maturity calendars that show at a glance the number of days between two dates. Each day of the year is numbered, and by taking the number of the date from the number of the due date the time may be quickly ascertained. Thus a note discounted on August 1, 1921, for three months is due November 1. August 1 is number 213 and November 1 is number 305, the difference being 92 days—provided the first of November does not fall on Saturday, Sunday or a holiday, in which case the note is due the next secular day not a holiday. Interest tables are also used in some banks, but prohibited in others. A simple rule for 6 per cent is. Multiply the amount by the number of days and divide by 60. For any rate. Multiply *amount* by *number of days* and again by the *interest rate* and divide by 360.

The words "value received" are no longer necessary to make a note complete.

Where the note is made, say, as of January 10 with interest and discounted January 20, figure the interest from January 10, add to the face of the note and deduct interest for the number of days between January 20 and the due date.

Loan Records.

The proceeds are credited to the depositor's account, if he has an account, by credit ticket. It is quite the general custom to make such credits, inasmuch as the depositor wishes to check against the account, and may do so as soon as the credit is entered, the same as if a cash deposit were made. Banks will also certify against such credits and may legally do so. The note is then entered on the "*Discount Register*," which contains a description of the note in full, maker, indorser, date, time, amount, where payable, discount and proceeds.

Having a record of the note, we must give it proper

attention when it falls due so that it may be presented (a) at the place, and (b) at the time, it is due. Therefore it is entered in the "*Maturity Book*" which classifies the notes by due dates. If the note is payable out of town, it is sent out for collection in time to be at the place of payment on the due date. This is quite essential.

Lastly, the bank must keep a record of each borrower, to determine how much has been loaned to him. Therefore the note is entered in the "*Liability Book*," which contains a record of all borrowers and the amount they have borrowed, both directly and inductly; or "as maker" and "as indorser." The note is then filed in the note files under its due date. Documentary stamps must be attached according to law, and this is in many cases added to the discount.

As loans and discounts are made, the entries are put through the liability book, thus increasing the line of the borrower, and as fast as paper matures and is paid off, the line is reduced. Paid notes are ruled out so that at a glance the items constituting the unpaid balance will appear. The purpose of this book is to prevent the bank from loaning more than the legal limit to a certain borrower and also to keep him within the prescribed limits set by the officials.

In the large banks the signature of the borrower is also verified to avoid spurious paper.

As a rule customers are advised of the discount credits at the time the transactions are put through so that their records may coincide with those of the bank.

It is the custom of most banks, although not obligatory, to send notices of maturing notes to the makers about a week or ten days before they are due. This is done from the maturity book, but is a courtesy only.

Some banks make the offering book a journal of the notes accepted, which are set forth in detail and also

classified under different forms, such as "own discounts," "purchased paper," "acceptances," etc , to classify the paper holdings of the bank

Collecting Maturing Notes.

The collection of maturing notes follows closely the procedure in other collections, except that a record is already in hand of the details of the notes and no further record is necessary except in cases of out-of-town items sent to correspondents. In this case record is made of the item, and to whom sent, with sufficient detail to identify the transaction. City collections are made through messenger or the clearing house, and country collections by mail. The unpaid items become "past due" after their due date has passed, and are closely followed and in due time legal action taken when other methods have failed of result.

Collateral Loans.

A collateral loan is one that is safeguarded by security. They are sometimes called "secured loans." In the bank with which the author is connected there is a loan secured by Bank of England notes, and he has been offered a fire insurance policy and a will as collateral. Somewhere between the two extremes lies the middle ground of safety. As a rule the officials make secured loans without consulting the loan committee, and in city banks they may be found in large volume. In this case we care not who the borrower is so long as his collateral is sound. The moral side of the loan is not a factor—the quality of the collateral is

Secured loans divide themselves into·


(a) Loans secured by stocks and bonds, in New York commonly called "street loans"

(b) Loans secured by merchandise, often spoken of as "warehouse loans"—meaning loans on goods in storage.

(c) Loans secured by assignment of accounts receivable.

(d) Loans secured by goods in transit and represented by bills of lading

In making loans on securities of various sorts, the first essential is the value of the security, viewed (a) from the standpoint of salability, and (b) from its intrinsic worth. Securities may be divided into listed and unlisted securi-

IRVING NATIONAL BANK			
WOOLWORTH BUILDING, NEW YORK			
			
<u>Nov 2</u> 1921			
<u>John Doe & Co</u> <u>150 Broadway</u>			
Please send us check for interest on your paid Loans as follows			
AMOUNT	DATE	NAME	INTEREST
1000-	10/31	John Doe & Co	31.87
E D JUNIOR, Cashier			

FORM 29 — Interest notice

ties and miscellaneous A listed security is one which is listed on a stock exchange and traded in constantly, and therefore has a broad market with the selling price indicated daily in the financial page of the newspapers throughout the country The New York Stock Exchange is the leading exchange of the country and the rules for admission are strict, therefore, the fact that a security is traded in on the floor of the New York Ex-

change is evidence that it has passed certain tests, but the Exchange does not warrant any fact connected with any security. There is also the Consolidated Exchange, which has other listings, and finally the "Curb," which is now housed in a building of its own.

There are certain stocks and bonds of high quality not listed on any of the exchanges, and traded in on the "Curb," which is a free market without the rigid rules of the other exchanges, but with a code of ethics quite as high as the regular exchanges.

There are also many unlisted stocks and bonds, issued by manufacturing and other concerns, that have a local market and yet are fundamentally sound.¹ There are still others that are doubtful and many that are worthless.

Of such are real estate stocks, stocks of new companies, promotion companies, etc. Even so good a security as a bank stock may have no ready market, if it be of some small bank whose stock is locally held.

It requires some resourcefulness to obtain certain quotations and more to find a buyer in a poor market for stocks and bonds that are out of the listed class. Banks do not lend freely upon such securities.

Good Delivery.

Having determined the value and the probability of a sale, we must have the security in such form as to pass from hand to hand—"good delivery" as it is called. This means, so indorsed that it will pass title and be transferred by the transfer agent. Coupon bonds are like cash and go by delivery. Registered bonds must have the form on the back properly filled in and wit-

¹ The most useful compendium for quotations is the "Quotation Section" of the *Financial and Commercial Chronicle*, published monthly. This gives the last quoted values of all classes of stocks and bonds in all parts of the country.

nessed, and if signed by agent, attorney, executor, etc., the authority must accompany. Securities in the name of corporations, societies, colleges, etc., must have proper resolution, certified by the secretary, and the transfer

Known all Men by these Presents,

THAT J. John Doe
 for value received, have bargained, sold, assigned and transferred, and by these presents do bargain, sell,
 assign and transfer unto Bank of Rockville, Md.
less shared
 of the Capital and Stock of the U. S. Steel Corp.
 standing in Twenty name U. S. Steel Corp. on the books of the said
U. S. Steel Corp.
 And I do hereby constitute and appoint Richard Roe of Rockville, Md.
my true and lawful attorney, IRREVOCABLY, for me and in any name and need
 but to sell, to sell, assign, transfer and make over, all or any part of the said U. S. Steel Corp. and for
 that purpose to make and execute all necessary acts of assignment and transfer thereof, and to substitute one or more
 persons with like power, hereby ratifying and confirming all that said Attorney
113 113 substance or substitutes shall lawfully do by virtue hereof
 In witness whereof, I have hereunto set my hand and seal
Rockville, Md. the 20 day of November 1921
 Signed, Sealed and delivered in the presence of
Richard Roe John Doe
 1207 Nov 9-20



Form 30—Power of attorney used in collateral loans

must be made by the proper officers. The same is true of stocks. Usually the certificate is indorsed in blank, and anyone receiving it thereafter can have the transfer made. It makes it a bearer instrument.

Where the stock stands in the name of a deceased person, the certificates of appointment as executor or administrator are required, together with comptroller's waiver (in New York) permitting the transfer

Many borrowers prefer a power of attorney, separate from the security, in order to avoid the evidence that the stock has been used as collateral, which indorsement on the back carries with it

Warehouse Loans.

Merchandise or warehouse loans are made in large volume by banks in various parts of the country, being more in evidence in the large cities than in country districts, although in the cotton and wheat growing districts these loans are to be found in all banks

The first essential in a merchandise loan is that the merchandise shall be as represented, and under the control of the bank. The quality and quantity can only be known by an actual appraisal of the goods, made by an experienced appraiser conversant with the particular commodity and market conditions. The second point is covered by the warehouse receipt which acknowledges receipt of the goods and covenants to deliver only upon production of receipt. Where goods are stored in standard warehouses, the issue of fraudulent receipts is only a remote possibility. Lastly, the goods must be protected by insurance, which needs no further comment, except that there should be a clause in the policy referring to the bank "as its interest may appear."

The risk in warehouse loans lies in depreciation in value and in deterioration in quality, and both must be given due attention

It is obvious that a loan made, for instance, on butter or cheese, or canned goods, wool, cotton, or any other

commodity, can only be as secure as the goods themselves, valued at a price that will be realized in a sale. In a rising market, such as obtained during the late war, a loan was quite certain to become better as time went by (provided, of course, the goods were non-perishable), because of the rising prices, but when the tide turned in 1920, and prices began to recede with a velocity that was not only dangerous, but towards an unknown end, any loan was risky. In such instances the bank watches the commodity prices most carefully and calls for reductions as fast as the margin of safety is in danger. Here the general worth of the borrower and his business integrity come strongly into play.

Loans on Goods in Transit

It is a common practice of banks to loan on goods in transit, safeguarded by the bill of lading. It is readily apparent that if a loan is secure where the goods are in a warehouse, it is equally secure on board ship or in a railroad car. In such cases the bank bridges the time between the loading of the car and the delivery of the goods. For instance, a car of wheat is sold by a Minneapolis firm to a wholesale grain merchant in New York. The terms are cash upon arrival of the goods. The goods may be en route for two or three weeks, and the seller would be obliged to carry this debt unless the banks can assume it for him, and thus they do by making a loan against the goods in transit secured by a draft on the New York merchant with bill of lading attached. As soon as the draft is paid and funds are returned by the New York bank, the loan will be liquidated. Goods in large volume are moved from seller to buyer and from place to place upon such credit furnished by the banks.

Loans Against Receivables.

The accounts of a firm for goods sold, being one of the quick assets, it follows that such assets are good collateral for loans, and they are so accepted by many banks. In substance the firm pledges its outstanding accounts receivable for present cash advances. These accounts are lodged by the firm under schedule, setting forth the name of the debtor, the amount and maturity of the bill. The bank takes these by assignment, and either collects the accounts or delegates the firm as its agent to make the collections for its account. Such advances are not usually made for the full amount, a margin of from 20 to 40 per cent being reserved as safeguard against non-payment.

There are two methods. First, the non-notification, under which the debtor is not advised of the assignment and the collections are made by the borrower and remitted to the bank, and second, the notification, where the debtor is advised to make payment direct to the bank.

There are numerous concerns formed for the purpose of loaning against such accounts, which make it a specialty. They have proven highly profitable and beneficial. Many merchants prefer to use these companies even at a greater cost than bank loans would entail, which is generally acknowledged to be the case.

The reasons are simple. In the first place, the merchant may be dealing with a bank which cannot, by reason of the limitations of the law, loan him an amount sufficient to handle his business. There are many banks with small capital, and these, being restricted to 10 per cent of their capital and surplus as a loan limit, are too circumscribed to give the customer what his business needs require. For instance, a bank with a loan limit of \$30,000 may have a customer who can profitably use

\$60,000 of discounts His statement and his balances may warrant the larger line He may, with the bank's consent, take some of his business to the commercial banker and there find the accommodation he needs

In many banks there is objection to this practice, inasmuch as it pledges one of the firm's best assets, and in credit statements this information is asked for It necessarily weakens the firm's position, and is a practice to be entered into with much care. However, it is done in large volume by merchants and manufacturers in all parts of the country, and the practice is growing very fast

The second advantage is the quick payment To illustrate. A furniture manufacturer sells a bill of goods to a department store on May 1, terms 10 days, 2 per cent, net 30 days As soon as he can secure proof of the shipment of the goods by carrier's receipt, he may take the account to the commercial banker and sell it, receiving 80 per cent of the face value Even though the account is paid at the end of 10 days, it will be 11 or 12 days before the funds reach him, while if the account is sold, he will be in funds in two or three days And time, even though short, is an important element in business life

In making such loans, banks and commercial bankers require (a) Assignment of the account, (b) invoice, (c) receipt of shipment; (d) agreement that the funds will be turned over to the lender as received in their original form—that is, the original check, and (e) that for any default in payment the borrower is liable But, having a stated line of credit, he may put in new accounts as fast as old ones are paid, and in practice the plan works out to the satisfaction of both borrower and lender

Automobile Loans

The automobile business has assumed such proportions that special methods of financing have come into play

as especially adapted to this business. The manufacturer sells to the dealer as a general rule for cash upon draft with bill of lading attached. In normal times the dealer does not order cars as he needs them, but must take them when and as the manufacturer or his distributing agent elects to ship them. Dealers generally sign a contract for a stated number of cars per year as their allotment, and if they are to be in position to deliver, they must have cars available. Many of these dealers are of modest means, and there have grown up many large and flourishing concerns specially organized to handle automobile financing.

The writer has had considerable and uniformly satisfactory experience with this line of loans. Their safety lies largely in the moral worth of the dealer, without which the making of such loans is risky. The process is built upon the element of trust, evidenced by a trust receipt. The procedure can be best treated by illustration. A dealer is selling a standard, modestly priced car that has a wide and steady market. He has a small capital and is of good repute. He finds that the manufacturer has shipped him a carload of cars, which he must accept or run the risk of not being able to make deliveries as cars are sold.

He approaches his banker with the invoices which cover the shipment, which may already be at the freight station. The invoices show the cost at the factory, plus freight and war tax, to be \$1,000 for each car. Inasmuch as the bank desires that he shall have some interest in the car besides the potential profit, it will advance him about 80 per cent. of the factory cost, leaving the freight, tax and 20 per cent. of the factory cost as his investment.

Upon giving the bank a trust receipt, whereby he agrees that the cars are the property of the bank, to be

kept insured against fire and theft, and to sell only upon its release, the bank will make the advance and release the bill of lading. The trust receipt identifies the cars by make, motor and car number, and type. The note is a demand note.

Upon making a sale the dealer must obtain a release from the bank, or his delivery does not carry good title. And upon paying the amount advanced upon each car this will be given. If the dealer accepts notes for part payment, the bank may release the car and accept the notes for discount.

If the car is sold on time payments, the bank will also require a conditional bill of sale, insurance policy covering fire, theft, liability and property damage as additional safeguard.

In the late fall, when the selling season is over, the dealer must stock up for the spring trade and needs his largest line of credit, for he must take his spring cars in the winter. These may be placed in a warehouse, with its attendant safeguards, or left with the dealer to be stored in his salesrooms. It is generally the practice not to allow such cars to be used for demonstration purposes, as this places them shortly in the used-car class.

Altogether the practice is safe—if you know your man, but otherwise there is some risk. Cars so held should be checked up at frequent intervals to see that they are still in stock, and comparison should be made with other banks where the dealer has such loans to see that the same car is not pledged twice. Otherwise there will be found no more liquid or more satisfactory line of bank loans.

Wall Street Loans.

Many of the large Wall Street houses carry with their banks large blocks of stocks and bonds, against which

they secure loans as needed in their business. The limit of the loan is fixed by the market value of the securities. As securities are sold they are withdrawn and others substituted or the loan reduced.

The Margin.

In lending upon stocks and bonds, commodities or receivables, it is essential that there be a margin of safety to protect the bank from overloaning, or sustaining a loss in case of depreciation in values. On some securities the margin is 20 per cent of the market value and on others 10 or 20 points. Thus on a bond of the City of New York, 80 or 90 per cent of the market value would be loaned, but on a stock such as Kennecott Copper, selling let us say at 20, the bank would require a margin of 10 points, and on 100 shares worth \$2,000 it would lend only \$1,000.¹

It is the function of the loan department or the one in charge of collateral loans (a) to see that securities are in proper form, (b) to watch the market quotations in order to keep the loans properly margined, (c) to be sure that for any securities taken out of the loan those of equal or greater value are substituted, (d) to see that the interest is collected when due, (e) to collect loans when called or at maturity, if on a time basis.

Bookkeeping of the Loan.

Collateral loans are entered in the Collateral Loan Register, with name of borrower, description of the security, rate of interest and market value of the security, and interest is collected at stated times during the year, such loans being as a rule payable on demand.

The security is placed in an envelope with the note,

¹These margins are given as illustrative only. The actual practice of various banks differs and should be verified at first hand for authentic margin ratios.

the data also being recorded on the outside, and filed in the vaults

The collateral note contains a clause in fine print wherem the security is pledged to the bank, and the latter is given the right to sell the same at public or private sale without notice in case the loan is not paid when due or called for payment

Loans for Correspondents

In addition to lending its own money, the city bank also lends for the account of its correspondents, particularly in what is termed the "call market," meaning demand loans to stock exchange houses payable on demand. In performing this service the bank acts with the same care and judgment as it does in its own affairs. In many instances there is no compensation. In others from $\frac{1}{8}$ to $\frac{1}{4}$ of 1 per cent is charged for the service and a guaranty of payment. In such a case the lending bank advises the city bank to place a certain amount out on call for its account. The city bank will make the loan, pay the borrower the funds, charge the customer's account, and either hold the securities for its account or forward them to the lender, usually the former. When the lender needs the funds, the loan is called, the amount with interest credited to the correspondent's account and the transaction is closed.

In making stock exchange loans, instead of the usual collateral note, often the broker signs a contract, which embodies in substance the agreement found in ordinary collateral loans, and this agreement covers all transactions which the borrower may have with the bank. By this contract the broker pledges the securities as listed in his loans, agrees to keep the margin good, gives the bank a lien on any and all securities of whatever nature in its possession as security for any and all

indebtedness of the borrower to the bank, and gives the bank the right to sell at public or private sale all such securities, with or without notice, and the right to buy them in for its account, etc

Collateral Must Be Mixed

In the larger banks, rules are in force as to the character of the collateral. Some banks favor mixed collateral—that is to say part railroad securities, commonly called “rails,” and part industrial and public utility securities, commonly called “industrials.” The reason for the latter rule is the fact that the mixture of securities avoids “putting too many eggs in one basket,” and also in the event of sale, a large amount of any one security would not be offered, thus depressing the market. The proper mixture of collateral is a matter of opinion and is for each bank to decide for itself.

The Loan Card.

The loan is recorded upon a loan card, or loose-leaf book, giving name of borrower and address, list of securities, market value, rate, and other details which the bank may elect. The payment of interest is also credited on this card when the time for payment arrives.

In the large banks loans made on warehouse receipts are listed on cards of different color, as are those made on bills of lading, thus enabling the bank to know how much of each class of loans it is carrying at any one time.

The Trust Receipt.

In handling warehouse loans it may become necessary to withdraw part of the goods in storage, either for sale or for purposes of manufacture. In this case the bank allows the borrower to take the warehouse receipt, upon giving his certified check for the amount, and if the goods are taken only in part, a new receipt for the balance

will be issued, or the delivery indorsed on the original receipt. Upon payment of a proportionate amount of the loan the goods are released.

In cases where the goods are to be taken out for manufacture, the bank takes a "trust receipt," which allows the borrower to remove the goods, but gives the bank continuing title to them in whatever form they may be at any subsequent time. The character of the one taking out goods on trust receipt is of course the dominant factor in goods held in trust. A breach of the trust would lay the borrower open to criminal prosecution in case the goods or any proceeds from them were misapplied.

Calling Loans.

It is not the practice of banks generally to call loans, except in cases where the margin has shrunk to the point of making such action necessary, and more frequently the call is for additional security or a reduction of the loan. There are times, however, when the calling of loans is necessary in order to raise funds to meet the demands of depositors, and these call loans are regarded in the light of a secondary reserve for such emergencies. In New York, when a loan is called, notice is given as a rule before 12:15, giving the borrower at least a few hours in which to make other arrangements. In other banks the procedure is not so strict, and a call loan is payable by mutual arrangement, although it may be called and its payment enforced at any time.

When loans are thus paid off, the collateral is delivered and receipt taken. In some cases a memorandum of the collateral is given at the time the loan is made, as identification; and this must be returned before delivery is made. This is particularly true in New York, where most of these loan transactions, running into millions,

are made through messengers, and proper safeguards must be observed.

When the Interest Rate Soars

The student who follows financial affairs will frequently see "call money"—that is, money loaned upon stock exchange collateral in the large centers—quoted at rates running as high as 25 per cent. This is on its face usury, and would be unlawful were it not for a specific provision in the law, especially in New York, that upon loans secured by stocks and bonds, and made in amounts of not less than \$5,000 and payable on demand, the rate of interest may be anything that the borrower and lender agree upon. This provision of the law was no doubt enacted to cover Wall Street operations, where money is a commodity to be sold to the highest bidder.

CHAPTER XIV

COMMERCIAL PAPER AND ACCEPTANCES

During the past twenty-five years there has grown into prominence a form of bank investment that arises out of commercial needs and is commonly called "Commercial Paper." The term simply means the single-name notes of merchants and manufacturers, payable as a rule in three or four months, and issued in denominations of \$2,500 and \$5,000. These notes are sold to banks as short-time and liquid investments through brokers who specialize in this form of security and the volume runs into large figures. It is not uncommon for firms of high standing to handle from two to three millions of such paper a week.

The Purpose of Commercial Paper

The American merchant and manufacturer sells his goods on book account with credit terms running from 30 to 90 days or longer. These accounts form his "accounts receivable," heretofore treated, and it is obvious that if he extends such credit, he must carry the financial load until the accounts fall due. In other words, he must allow the buyer to order goods and pay for them after a period of time, often long enough to allow a re-sale before payment is due. He must, as a practical necessity, be strong enough financially to carry his debtors, or borrow for the purpose of carrying this burden.

Another reason for the existence of commercial paper is the practice of offering cash discounts for prompt payment. It follows that if a merchant is to pay cash,

he must have cash, in order to take advantage of these concessions. Commercial paper forms the medium through which these operations are financed. The practice can best be understood by a typical example

Financing Through Commercial Paper

A shoe manufacturer is preparing for his spring trade. He must lay in a supply of leather and accessories, and pay labor during the process of manufacture. He needs \$100,000 in addition to his working capital to operate his factory. By paying for the leather within ten days of the invoice he may obtain a discount of 2 per cent, or a saving of \$2,000. As the shoes are sold and shipped to the retailer, he charges the amount on his books as a receivable, also subject to discount if paid within certain periods. His local banks may not be large enough to loan him such an amount, and besides he prefers to keep his home credit open for cases of emergency. Then, too, he can often borrow in the open market at a lower rate than at home.

He has an audit of his business made by a public accountant and the results set forth in a statement and certified as correct. Fortified with this information, he approaches a commercial paper broker and offers twenty \$5,000 notes payable in four months.

After a careful examination of the merchant's affairs, and investigation of his past history and his moral standing, the broker agrees to "take on the name"—meaning to sell these notes to banks in various parts of the country. A digest of the statement is made and given to the salesmen who cover the banks, and is sent out by mail to the broker's clients. The broker either remits the proceeds as notes are sold, or more often pays the merchant for them on delivery, less the discount and commission.

The banks will purchase these notes, after satisfying themselves that the credit risk is sound, and hold them until maturity. They thus have a short-time obligation which they are under no obligation to renew, and the merchant has funds with which to pay for his material and his labor, taking advantage of the discounts as above noted. By the time the notes fall due, the retailers will have liquidated their accounts, and funds will be in hand to meet the notes at maturity.

Practically all the large concerns finance themselves for temporary needs after the above fashion, and it is distinctively an American idea.

In purchasing these notes, the bank requires the following:

- (a) A recent statement that is certified
- (b) Quick assets of at least 2 to 1, except in certain lines
- (c) Favorable reports from the banks given as reference.

The paper is never indorsed by the broker, but the notes carry with them the guaranty of genuineness. They are usually sold under option of ten days, for checking purposes, and if unsatisfactory, they may be returned and the money will be refunded.

Checking Paper

In checking the paper, the banker analyzes the statement after the manner laid down in "Commercial Paper and Analysis of Credit Statements"¹ and indicated in the discussion of the quick assets and quick liabilities, herein, giving particular attention to these items. The banks given as references are then communicated with, and if favorable reports are received the paper is accepted. Rarely indeed do these notes fail of payment. The

¹ By the same author

history of commercial paper even in a period of readjustment is exceptionally good ¹

Country banks are large buyers of commercial paper, inasmuch as the local demand for loans does not absorb all their deposits, and they find it necessary to go outside their local field for loans. There are many banks that have seasonal increases in deposits, such as seashore and mountain resort banks, banks in farm districts, etc., and have funds for short-time investment. These are placed in commercial paper, on account of the short maturity. Paper can be bought maturing at any time desired, as for instance in December, when banks operating Christmas Clubs make their annual distribution of Christmas money.

Acceptances.

An acceptance may be defined as a bill of exchange which has been accepted, or, to go into more detail, an unconditional order signed by the maker, addressed to a second party, directing him to pay on demand or at a determinable future time, to a third party, a sum certain in money, which instrument, after being presented to the drawee and having his name written across the face, becomes an acceptance.

During the past few years propaganda has been spread far and wide by chambers of commerce, banks, bankers'

¹ There are approximately 3700 concerns in this country with a capital in excess of \$250,000 selling their notes in the open market. The amount of paper sold between January 1st, 1920, and July 1st, 1921, was approximately \$4,000,000,000. All but \$104,000,000 of this vast sum was liquidated at par without effort on the part of the banker. Eighty-nine concerns or only 2.4 per cent of the whole number selling paper found it necessary to ask any indulgences on the part of the bankers. Sixty per cent of these will pay in full, while it is estimated at this writing that only \$18,700,000 or 0.0047 per cent of the total paper issued will prove a loss. (From figures compiled by the National Credit Office and published July 25th, 1921.)

New York Sept 1 1921		No. 327	
CITY OF DRAWER			
ON December 1 1921		PAY TO THE ORDER OF OURSELVES	
(DATE OF MATURITY)			
Five hundred		DOLLARS (\$500.00)	
<p>THE OBLIGATION OF THE ACCEPTOR HEREOF ARISES OUT OF THE PURCHASE OF GOODS FROM THE DRAWER. THE DRAWEE MAY ACCEPT THIS BILL PAYABLE TO ANY BANK, BANKER OR TRUST COMPANY IN THE UNITED STATES WHICH HE MAY DESIGNATE.</p>			
TO Thomas Roe		BY Richard D. Roe	
(NAME OF DRAWEE)		(SIGNATURE OF ACCEPTOR)	
12 South St.		LOCATION OF BANK	
(STREET ADDRESS)			
N. Y.		BY John Doe	
(CITY OF DRAWER)		(SIGNATURE OF DRAWER)	

Form 31—Trade acceptance

associations, credit men's associations, etc., advocating the use of the trade acceptance in place of the account receivable, until their use has been adopted by firms large and small in great numbers throughout the country.

The one danger lies in the fact that an irresponsible party may make acceptances, just as he would give a bogus promissory note, and therefore put in circulation an apparently good instrument to deceive the unwary. Of such nature were the acceptances mentioned in the true matter discussed on page 150. In this case the buyer induced the seller to give him large quantities of ties upon signing acceptances, which the seller passed on to his bank, and both merchant and bank were caught in the same net.

The term acceptance is practically a new one in American finance, and has been operative only since the advent of the Federal Reserve System. The instrument itself, however, and the idea upon which it is based, is as old as finance.

The basis of an acceptance is a bargain and sale of goods and a bill of exchange or draft—seller upon buyer. The reason for it in this country may be said to be the unwieldiness of the account receivable. In selling goods upon open book credit the following disadvantages follow:

Book Credit.

1. The seller has an account on his books which ties up his funds until the debt is paid. If he sells this account he weakens his financial position, the cost is heavy, and the process cumbersome and slow. He may cover himself by selling commercial paper, but this puts the burden still upon him of making payment when due. The seller finances the buyer.

2 The open account has no rigid due date. It may be paid in ten days, thirty days, three months, or never. Even if the buyer is prompt and takes his cash discounts, it will be at least eleven or twelve days before the seller may expect payment. And a few days does not matter with the debtor.

3 The buyer being under no restraint as to buying, is tempted to overbuy, and to return goods not quickly salable or which have depreciated in value.

4 If payment is not made as agreed upon, the seller must use moral pressure, collection letters, and importunity, to collect his money, and if the account becomes stale, his redress is an action for goods sold and delivered, subject to all the offsets as to quality, quantity and guarantees that the buyer may set up.

Advantages of the Acceptance

On the other hand, let us review the advantages of an acceptance to the seller.

1 The seller has tangible evidence that the goods are acceptable. The buyer, by accepting the draft, consents that the goods are received, and that payment will be made as stated in the acceptance.

2 The seller has an instrument that he can discount at his bank the same as he could a promissory note, which it really is.

3 The due date is rigid and payment must be made at that time or protest follows. Therefore the buyer will hesitate to commit himself to burdens he cannot carry. He will buy wisely because he must pay promptly, or suffer in loss of credit standing. He will extend credit carefully because he has assumed definite engagements as to his payments.

4 In case of default action is brought on a self-proving instrument that is self-sufficient in a court of law.

The bank discounting the same will have a perfect banking instrument and one that may be rediscounted at the Federal reserve bank. It will have definite maturities and liquid assets, running off all the time.

Let us show the contrast by taking a business engagement and following both methods. The firm of A & B have contracted to furnish the material for building a structure on open credit payable in 30 days from delivery. As the goods are delivered they are charged to the contractor. At the end of 30 days the contractor finds his mortgage payment has been delayed and holds up the seller for a week. He shows a good reason, but that does not settle the debt. Dispute arises as to deliveries, quality and quantity of material, etc., that make a long-drawn-out affair. If A & B need to borrow, they must do so upon their own paper and must carry this building operation until completed, with their own credit. They cannot in good conscience hypothecate this account, for to do so would invite criticism of the banker.

But suppose A & B arrange with the contractor that as fast as goods are delivered they will draw a draft on him for the particular amount, which he accepts and returns to them. He acknowledges the receipt of the goods. He promises to pay for the same 30 days from date. He cannot dispute his promise. If he fails to meet his acceptances, they go to protest and have a high standing in court.

On the other hand, the seller can take these acceptances to his bank and immediately receive credit for the proceeds, relieving him of the burden. And if the seller gives acceptances for the goods he buys, his acceptances find lodgment in banks which carry the load for him. We therefore have a highly useful form of credit and a perfect banking arrangement.

The utility and advantages of the acceptance over the book account are fast becoming recognized by business houses and their use is increasing very fast. Even the small firms are now selling upon such an arrangement, finding that the banks favor them, and the buyers are willing to give them, once their practicability is seen. They carry *prima facie* evidence of their origin, and are freely accepted by banks everywhere in preference to other forms of commercial instruments.

The time will come when the open account will largely disappear from commercial statements, except in the case of the small retailers, who must still continue to sell on book credit.

Note to Second Impression

Since the above was written there has been uncovered a widespread conspiracy to defraud banks and discounting houses by the use of trade acceptances. These instruments, running into very large figures, have been drawn and accepted and passed into circulation as pure accommodation paper, without value of any kind passing between the parties. The plot came to a head through the simultaneous bankruptcy of four firms, with nominal assets, and hundreds of thousands of dollars in acceptances outstanding. The matter is now in the courts and in the light of recent experiences, the author must reverse himself and conclude that while the trade acceptance is all that is claimed for it, it is subject to very grave abuses in the hands of the unprincipled. This does not destroy its utility and usefulness, but emphasizes the duty on the part of the banks to scrutinize most carefully the origin of such paper, the relation between the parties, and the general worth and moral standing of the parties thereto.

CHAPTER XV

BANK ACCOUNTING

The difference between a large and a small bank is in degree and not in kind, for the same *character* of work is done in both. When the Comptroller of the Currency or the New York Banking Department sends out a call for statement, the same blanks are sent to all banks irrespective of size. The large bank may assemble its figures from many departments, and engage many men in making up the returns, while the small bank will make up its report from a few books and the work may be done by one man, but both banks must set forth the same facts. It may, therefore, truthfully be said that the books of one bank will fit the work of another, and in the sense that the books all perform the same basic functions, bank bookkeeping may be said to be alike the country over.

It would be futile in a work of this character to attempt to describe the minutiae of bookkeeping, inasmuch as it would involve a detailed description of each book of record used, and this would prove confusing and accomplish no good purpose. It will suffice for the student to know the facts that all banks must ascertain, leaving the exact method for the time when the actual work must be done in a banking institution.

And besides, to describe forms and their composition would indicate that a certain arrangement is favored or proper; which is merely a matter of opinion. Many men of many minds have studied the question of bank accounting and each has, in his own way, either by adaptation or imitation, devised the forms best suited to his needs.

Corporate Records

The Minute Book. All corporations, banking and commercial, are required by law to keep certain records relating to the corporate affairs as distinguished from the purely mechanical operations of keeping books. There must be a record of the proceedings of the board of directors, kept in a *minute book*. This should be in loose-leaf form so that the matter may be typewritten. The record should begin with the date of the meeting, the members of the board present, who presiding, and who recording. Then follow the reports, resolutions, new business, motions carried and lost, and a full chronicle of what happened at the meeting. These records should be indexed by proper names, subjects, resolutions and reports. A record also should be kept of the election of directors, when they retired, died, etc., and also a record of the incumbency of each office, the time elected and the time served.

It frequently becomes useful, from a historical standpoint, to know when the directors and officers were elected and when their offices became vacant, and the best time to write history is while it is being made.

Capital Stock Records. There must also be a record of the stockholders and their ownership of the bank's stock. The stockholders, being the owners of the bank, must, at stated times and otherwise, be communicated with, and it is essential for dividend and voting purposes to know who and where the stockholders are, and in fact the law requires that this information be kept in the office of all corporations. To this end we have a *Stock Ledger*, which has an account with every stockholder. The record shows the number of shares bought and the number of the certificate issued, also the number of shares transferred from time to time, to or from the holder in question. The total amount shown by this

book must always equal the total of the stock issued, thus, if the capital of the bank is \$100,000, the stock ledger will show 1,000 shares of stock outstanding in the different names, the total par value of which is \$100,000.

Stock Book. The stock book is merely the stock certificates in bound form. There is a stub on which are recorded the date, owner, number of shares issued to him, and, if a transfer from another, the original owner and the certificate number from which the transfer was made. Some banks also have provision for receipting for the stock certificate on the stub.

Stock which is issued must bear the signatures of two officers, usually the president or vice president and cashier, under seal. When stock is transferred from one owner to another there must be the legal amount of stock transfer stamps attached to the cancelled certificate. In New York two cents per hundred Federal and the same amount of state transfer stamps must be so attached.

Stock Transfer Book. In order to have a journal account of the stock transferred, there is a *stock transfer book*, which records on one side the number of shares transferred, certificate number and party from whom stock is transferred, and on the other side the new certificate number, and number of shares and name of the one receiving the stock, thus giving a chronological record of all changes in the stock ownership. The order in which these books are used is Cancellation of old certificate; issue of new, recording in stock transfer record, and from the latter into the stock ledger.

Stock Control

The foregoing processes account for the historical side of the bank as it is written in the board and committee meetings, and the changes in ownership of the bank.

itself. Needless to say, he (or they) who owns or controls 51 per cent of the stock of the bank is the power in affluence, since he controls the policy and personnel of the bank. The stockholders elect the directors, and the directors elect the officers, therefore in order to dictate the policy of the bank, the actual control of the bank must be held in stock ownership. The writer has been present at a bank meeting where the vote was 501 shares to 499, out of 1,000, one side having purchased one share more than half the total issue, and the other side voting either as owners or as holders of proxies the entire remainder of the stock. Right here let it be said that a proxy is a dangerous thing, for it may be canceled at the last moment. A proxy in New York is good for eleven months, and in a bank election cannot be held by a teller, clerk, director, officer or employee, and as above stated, may be canceled at any time without notice and another substituted. They are risky instruments in a close contest.

The Statement Book.

In the operation of a bank it is essential that its position be known at all times, (a) for the guidance of the officers in the conduct of the bank, (b) to inform them of the progress of the bank, and (c) to prove that the work is in balance. The statement book is therefore the pivotal point at which all other records concentrate and is a summary of the entire work of the bank at the time stated. It schedules all assets and liabilities, which must exactly equal each other.

Ratio of Reserve

The most useful function of the statement book is to show the ratio of reserve which the bank is carrying; for without this knowledge the officers could not continue to make loans. The law requires that a certain

proportion of the deposits be carried in reserve, and unless this amount is known, the officers cannot tell whether to reduce their cash holdings by making investments, or by increasing deposits through loans as previously stated, to decrease the ratio of reserve. For instance, if a bank is required to carry a reserve of 10 per cent and the statement as of this morning shows that its reserve is 20 per cent, the officers will immediately get the idle funds working, by making either investments or loans. The former would reduce the cash holdings, and the latter decrease the ratio of cash reserves by increasing the deposits; both processes reducing the ratio of reserve to deposits. To keep too large a reserve is to forego profits, and to keep too little is to work on so small a cash margin that any unforeseen call for funds will necessitate selling securities, borrowing money, discounting paper, or calling loans. Therefore the reserve ratio is given careful and constant attention, and is reported to the officials in the large banks each morning. Some banks have a summary of the statement for each officer, while in the small banks, the officials consult the statement book itself.

General Ledger.

The statement book contains every account on the general ledger of the bank, of which it is a transcript. Therefore as preliminary to the statement book there must be a general ledger which assembles and classifies all the work of the bank at one central point. In the large banks the various departments will turn in their figures at the end of the day to the general ledger book-keeper, who will make up his ledger accounts, while in small banks the same results are obtained from the various clerks. The general ledger contains an account with every form of asset and liability that pertains to

the work of the bank, many of these accounts changing every day. The figures are first carried to a journal sheet for the day, and from the journal to the ledger, and from the ledger to the statement book.

For Every Debit a Credit

All deposits received by the teller are credited "Due depositors" account, and all checks paid are charged, the difference being the increase or decrease in deposits. There being many such accounts, it is the custom to carry account with each class, such as savings accounts, checking accounts, Christmas Club, if any, etc. It is also customary to divide the checking accounts into groups, such as A to L, M to Z, and before posting is made, the deposits and checks must be sorted out accordingly. The purpose of the classification is to have a control over the ledgers, by groups, and the smaller the group the easier it is to check errors.

In a great many instances there are double postings created by a single transaction, one account being debited and the other credited, in fact, *for every debit there must be a credit*, and each transaction is examined before putting through to see if it balances in itself, otherwise there would be a difference at the end of the day. The exception is in entries where cash is automatically debited or credited. For instance, when interest is collected, "interest received" is credited and cash is automatically debited, if an expense is paid, "cash" is credited and "expense account" is debited.

Where, for instance, a collection is made for the account of a customer, the bank making the collection would be charged and the customer would be credited, if not, there would be a difference in one of the accounts, thus throwing the whole balance sheet out of true.

In departmental banks each department proves its own work, and it follows that if each is in proof, the whole work when brought together must also prove, and the same is true in small banks where a department is merely the work of one man. If the receiving teller's work is in proof, and correctly turned over to the book-keeper, unless some counterbalancing error has occurred, any error subsequently shown to exist could not be in that part of the day's work.

Whether the bank be large or small, the following facts, in addition to the information furnished by the general ledger and statement book, are necessary to its smooth operation.

Accounting Records.

1 Record of each collateral loan, date, maker, collateral, market values, rate of interest, record of interest due and when paid (collateral loan register)

2 Record of notes maturing each day, maker, amount, where payable (maturity book)

3 Record of notes discounted, date, maker, indorser, time, rate, when due, where payable, number (notes discounted register)

4. Record of borrower's liability, direct and indirect (liability book)

5 Liability of the bank to customers in the checking, savings, Christmas Club and other departments (individual ledgers, savings accounts, Christmas Club cards, etc.)

6 Cashier's checks issued (cashier check register)

7 Certificates of deposit issued (certificate of deposit register).

8 Certified checks issued (certified check register)

9 Checks issued against reserve balances (draft register).

10 Mortgage register, recording name of mortgagor, date of mortgage, location of property with diagram, appraisal value, insurance carried, taxes paid, certificate of title, interest payments, etc., etc (mortgage ledger)

11 Safe deposit records, such as list of box renters, number of their boxes, who may enter, payment of box rents, etc

12 Index records of all names on the books of the bank, so that any account in any department may be quickly located. Signature cards are filed by name in the commercial accounts, and by number in the savings department, with alphabetical index.

Bond Records.

Name of security, date issued, date bought, price paid, broker, number of bonds, par value of each, rate of interest, discount or premium paid, market and book value, record of interest due and when paid (bond register).

Collections

Date received, from whom received, on whom drawn, maker, where payable, amount, to whom sent, instructions and fate (collection register)

Depositors' Accounts.

In keeping the accounts of the depositors, they are grouped as before noted, and are kept by one of two methods, the Boston Ledger or the Burroughs Book-keeping Machine method. (There are other machines also used for this purpose, but the Burroughs predominates.)

The Boston Ledger is a bound book with the names of the depositors printed or written on the left, which

answers for the life of the book, which is from three

months to six months. The balance is carried forward each day, and spaces are ruled for "balance," "deposits" and "checks." There is a space for each day, and no dates are written, the column being headed for the day. Taking the balance as a beginning, the clerk enters the deposits from the deposit slips in the deposit column, and the checks in the check column, and the new balance is struck, which forms the basis of the next day's work. Where there are several checks of one name they are totaled on adding machine and treated as one charge. Other credits such as proceeds from loans are marked for identification, for example, "N D."—note discounted. Interest is marked "Int." Charges such as notes are charged to the account "D M."—debit memorandum, etc.

Many banks distinguish clearing house checks by posting in a colored ink.

After postings are made and balances extended, the pages are totaled and the total of the balances must agree with

NO.	NAME	Monday			Tuesday			Wednesday		
		CHECKS IN DETAIL	TOTAL CREDITS	DEBIT	CHECKS IN DETAIL	TOTAL CREDITS	DEBIT	CHECKS IN DETAIL	TOTAL CREDITS	DEBIT
		BALANCE			BALANCE			BALANCE		
1	Bank of Boston	5 10 37 ⁰⁰	91.50		8 5 27 ⁰⁰	10 3 50 ⁰⁰		10 3 50 ⁰⁰	10 3 50 ⁰⁰	
2	Bank of New York	10 3 50 ⁰⁰	10 3 50 ⁰⁰		10 3 50 ⁰⁰	10 3 50 ⁰⁰		10 3 50 ⁰⁰	10 3 50 ⁰⁰	
3	Bank of America	10 3 50 ⁰⁰	10 3 50 ⁰⁰		10 3 50 ⁰⁰	10 3 50 ⁰⁰		10 3 50 ⁰⁰	10 3 50 ⁰⁰	
4										
15										

Form 32—Boston Ledger showing two days' work

the general ledger, to which the amounts have been posted from the teller's lists. This assumes that all items received by the teller and turned over to the bookkeepers have been accounted for.

Machine Posting.

Machine posting is fast coming to the front and is now used by thousands of banks throughout the country. The machine automatically adds and subtracts and strikes the balance. In posting, the operator "picks up" the balance as shown in balance column, the machine moves to the check column, where the checks are printed, then to the deposit column, where the deposits are posted and then to the balance column where the balance is shown. If there is an overdraft, the machine locks until a lever is pulled, when it prints the amount in red with "O D." preceding, showing the account to be overdrawn. The date of each entry is printed in red automatically, and once the machine is set for a certain date it prints this date until changed. Each entry is therefore sure to be correctly dated. In this method the procedure is as follows:

Checks and deposit tickets after leaving the cage or rack are sorted by groups, and a total taken. They then go to the bookkeepers, who make the postings direct from original items. "Short" checks that are not to be paid are taken out and laid aside. After posting is complete the items go to the check clerk, who enters them on deposit and check lists, respectively, in alphabetical order, without names. The total of these lists must agree with the rack lists, less the items to be returned as unpaid.

The statement clerk then enters the deposits and checks on the statement sheets by similar machine work, and it follows that if the same work is done on two sheets, the

results must be the same. As postings are made the sheet is offset to indicate that the account was changed during the day. When all postings are complete, the balances of the accounts that were offset are called back, statement to ledger, and the balances must agree. The ledgers are then run up in total, which total must agree with the bookkeeper's work, since he has charged the ledger with the checks drawn against that group and credited the deposits.

There are thus three checks upon the accuracy of the postings (a) The total debits and credits must agree with the listings of the items made before turning over to the bookkeepers, (b) the total balances on the ledger must agree with the general ledger, and (c) the work on the statement must also tally with the work on the ledger. Errors are therefore practically eliminated. It is unlikely that two men will make the same mistake in doing the same work in two different places.

The work of the individual ledger bookkeepers in the Boston Ledger system is monotonous in the extreme and trying at best. It is a continual round of adding and subtracting day in and day out. After the postings are made the balances must be added, page by page, and the totals must agree with the general ledger control accounts. In the machine system, not only is the nerve-racking work of constant adding and subtracting avoided, but speed is augmented and the cost of operation is vastly lessened. One good operator on a machine will do more work with less effort than four clerks by the Boston system. It is another example of machine work supplanting human effort.

Rendering Accounts Stated.

There are two methods in vogue for rendering the depositors of the bank statements of the transactions on

the account. First, by balancing the pass book. This consists in making a total of the deposits on the pass book itself, which must be left at the bank for balancing, adding whatever credits there may have been that were not made at the windows. The paid checks are then totaled on the adding machine, and the total taken from the sum of the deposits, the difference being the balance due the depositor. This must agree with the balance shown on the bank's ledger. When the book is balanced, it is so indicated on the ledger, usually by stamping the account "Balance" at the time the balance is effected.

The disadvantages of this method are many. Books cannot be balanced unless left at the bank, and in the meantime deposits may be made that must subsequently be entered, making it necessary to verify the deposit from the ticket or duplicate returned by the teller when the book was not presented. Some books are presented every month, making a congestion at the end of the month, while others remain outstanding for months, thus making a long period over which missing entries must be located. At best an average of 10 books per hour would be considered good work, while some accounts, long unbalanced, may take an hour or longer running down missing items.

Many banks have of late years substituted the statement system for the balancing of books. In this method, the items are posted on statement sheets after being posted to the Boston ledgers, and the results must agree.

In the machine posting, the statement is always ready, and at the end of the month statements are sent to all customers, which custom also obtains where the ledger and statement system are used jointly. In preparing the statement for return to the depositor, the following process is used. The vouchers are taken from the files and counted by number, which must agree with the number

of items on the statement sheet. The amounts are then checked off and the balance indicated in its proper place, when the statement is ready for the customer.

It is a rule of law that a customer must reconcile his account with the bank within a reasonable time, if any claim for forgery or alteration is to be effective. In New York such a claim must be made within one year after the return of the vouchers, or the right against the bank ceases.

Disposition of Deposit Tickets and Checks.

After the postings have been made the original items are ready for filing for future reference. The deposit tickets are filed by themselves usually by dates, the debit and credit tickets may either be returned with the vouchers or filed by themselves. Debit tickets are usually returned to the depositor to advise him of the charge, and a duplicate may be filed for the bank's records, while credit tickets are usually kept by the bank, the depositor having been advised by mail of the credit at the time it was made.

Checks are punched with the word "Paid" together with the date in figures, thus Paid 10-29-21.

This prevents the check being presented again for payment and cancels it permanently. They are filed according to name in the check files and taken out when the book is balanced or when the statement is made up. A record is taken of statements sent out, and usually the customer is asked to receipt for his vouchers. It is important that the bank have a record of such returns, for the paid vouchers are valuable instruments.

Time Deposits

Inasmuch as the Federal Reserve Act as well as many state laws require a lesser reserve for time deposits than for demand, it is necessary to segregate the time deposits

from the demand. A time deposit is one which may by law require notice of withdrawal of not less than 30 days before payment can be required. In the large banks, these deposits are kept in separate ledgers or preferably on cards, according to number. If notice of withdrawal is given, they are taken out of the time deposits and placed in "time deposits—notice of withdrawal given," making them essentially demand deposits.

Certificates of Deposit.

In accounting for certificates of deposit separate ledgers are also used, classifying these deposits into "demand" and "time." On the demand deposits the full reserve must be carried; and 31 days before the maturity of a time certificate it is taken out of the time and placed in the demand certificates.

The Bookkeeper's Work

The work of the bookkeeper is more than mechanical, as would at first sight appear, for he is charged with many additional duties besides posting and proving accounts. He cannot blindly enter all deposits and credits and checks and debits, he must "use his head" while using his hands. First, he must watch for overdrafts and pay them only upon proper authorization. Second, he must look out for signatures, raised checks, errors in filing, dates, stop payments, etc. In fact he must be a second paying teller and have a care over the same things. But more, he must be on guard against drawing against uncollected funds, and in this work he stands alone, for no one in the bank can prevent this but himself.

Somewhere in the bank the deposits must be analyzed to detect out-of-town checks received for deposit, against which payment should not be made until collec-

tion has been accomplished. In the ordinary bank, extreme analysis cannot be given each deposit, and the best that can be done is to give the account due attention to detect such drawings. To this end the entry may be marked "Hold" "Hold 3" or with a similar notation, to indicate that payment must not be made against the deposit for three days.

It is also the duty of the bookkeeper to keep records of accounts closed in order that the reason may be ascertained, the signature card removed from the files, and that such departments or officers as are in charge of the work may give the matter due attention. Frequently a customer of the bank closes out for inattention, incivility, misunderstandings, lack of service, etc., and if the reason be known the cause may be removed. Some banks also have a rule that balances over a certain amount shall be reported daily, and also drastic changes in the balances.

Inactive Accounts.

Many accounts in a bank are inactive, or become so by virtue of small balances remaining when the account is almost closed out by the depositor. These balances are also unadjusted debits and credits, or discrepancies between the customer's account and that of the bank, uncredited interest, etc., and are found in all banks in more or less volume. In order that the daily work may not become congested and additionally burdensome by virtue of handling a great many dormant accounts, they are taken out of the regular work and placed in a ledger by themselves. The customer is advised of the outstanding balance and it is either brought to life again or closed out. Banks do not encourage dormancy of balances and endeavor to avoid them as much as possible.

Irregular Items.

It is also the bookkeeper's duty to watch out for accounts of deceased persons, bankrupts, accounts that have been attached, etc. Such accounts are marked with a danger sign, and checks drawn against them are referred to an officer, or in the large banks to the legal department, which authorizes payment of irregular items. In the accounts which require the counter signature of a surety company—and there are many such—it is essential that the checks shall be so countersigned before payment is made, and this too is referred to an officer or legal department for authorization. In departmental banks irregular checks are taken out of the work and sent to the collection department, to be given more careful attention than the rush of the bookkeeping department permits. Where checks are drawn against uncollected funds, they are returned with notation of the cause of the return, and often with the request to put through again for payment.

Interest on Deposits.

The custom of paying interest on checking accounts has of late years grown to enormous proportions, and is one of the problems of banking. It is primarily due to competition between banks, each bidding for business through the payment of interest. So keen has this competition become that it has been regulated in many places by clearing house rules, making the rate uniform. The only competition in such places is in the rules of payment and the concessions made, which are also under regulation in certain cities.

It is obvious that if a bank were to pay interest on the balances shown on the ledgers, it would pay upon some funds which it did not have in possession, and the proceeds of loans, made by itself, both of which would

be losing propositions. Therefore it is necessary to eliminate from the interest calculations all such items. To do this, large banks operate an interest department which ascertains the interest balance each day. This it does by taking the actual balance at the beginning of the day, and adding only the cash receipts and those checks which are immediately paid. If, for instance, the actual balance on which the bank should pay interest is \$10,000 at the beginning of the day, and deposit is made of \$1,000 in cash, a check that will be paid the next day, and one the day after, the interest balance will be \$11,000, less the checks paid during the day.

Such care cannot be given to interest calculations in the ordinary bank, the labor cost being prohibitive. To offset uncollected funds, small banks eliminate a certain amount, such as \$1,000 daily, from the balance, paying interest upon the remainder.

In order to take the interest work away from the first of the month, which is always a busy period, banks figure interest from about the 27th of the past month to the 27th of the current month. Having the interest balance for each day, the interest is calculated by adding the amounts for each day, counting the full number of days to each month, and treating the sum as the interest balance for one day. In other words, add the balances for each day, multiply by the rate and divide by 365. The interest is usually credited the depositor with advice to him, and in many banks the list of balances upon which interest is paid is sent to him.

Analysis of Accounts.

In the operation of a bank it becomes needful to ascertain the sources of loss as well as of gain, in order to so direct the policies of the bank that losses will be minimized and profits enhanced from each of its many

activities. These profits and losses may be direct or indirect. The direct losses and gains may be traced to their source, but the indirect can only be approximated, and some cannot be measured at all. Among the unseen losses are those arising by virtue of payments against uncollected funds, interest paid on funds not actually in hand, and exchange charges absorbed by the bank in one way or another. Then, too, there is the cost of handling the business, stationery, labor costs and overhead, which must be realized out of the loanable funds, which funds consist of depositors' balances.

It is apparent that every account carries with it certain costs, and if the balance is insufficient to cover these costs it is a source of direct loss, whatever the indirect profit may be. And even an apparently profitable account may in the last analysis prove an unprofitable one. Therefore many banks have found it profitable and necessary to analyze each account to ascertain whether it entails a loss or produces a profit.

The subject of account analysis permits long and deep study, and there are many opinions concerning the true method, which need not be reviewed here. Suffice it to get a general idea as to the process, leaving the student to pursue the subject further should such study be warranted.

The basis of the analysis of the account is the amount which is available for loaning purposes, and this consists of funds actually in hand, less the reserve carried. In other words, all uncollected items must be taken out of the balance, together with the amount arising from loans, and the reserve. Having found the average loanable balance for a month, the average loaning rate for the month must be known, to obtain the earning power of the account for that time.

From this must be deducted the interest paid the

depositor and the cost of carrying the account, including the cost of handling the items that pass through the account. If the bank can ascertain how much it costs in labor, overhead and stationery to handle a check, the unit of cost is established, and the number of checks paid multiplied by the unit of cost will give the expenses assessable against the account. These operating costs together with the interest paid represent the outlay upon the account, which, taken from the earnings, shows the profit or loss. It is obvious that the special services rendered by the bank in furnishing credit information, trade information, handling securities and loans, and the many incidental services that obtain in the conduct of a bank, cannot be allocated to the accounts in a scientifically correct manner, nor do banks endeavor to figure costs to such a nicety. What they do want to know is whether the account is a profitable one or not, as analyzed above, leaving the other costs of bank operation to be absorbed by the general volume of business.

By reason of what may be called the social ramifications of banking, an account may show a distinct loss and yet have such a peculiar setting that it indirectly produces satisfactory revenue for the bank. An illustration will show the point. In a certain branch of a New York bank, a loan of \$400 was made on Liberty Bonds. The average balance of the borrower was less than \$50, and the credit department of the home office criticized the loan and ordered it paid. The manager of the branch informed the credit man that if that loan was called at least \$15,000 of balances on deposit by the borrower's family would go with it. The credit man changed his mind. It is most difficult to determine where these social avenues lead, and only as the banker knows the peculiar setting of each transaction can he work to advantage in handling the bank's deposits and

its loans. A great fire can be kindled by a little indiscretion or a little ignorance, and all bank men have found it out. Therefore, many apparently profitless accounts are carried as a matter of good will—that plant of slow growth, so easy to lose and so hard to gain.

Expenses.

The operating costs of a bank are high, and its expenses are many. These costs may be approximated at the beginning of the year and apportioned over the twelve months, or they may be taken as they come. Certain costs are being met every day, some weekly or monthly, and some once or twice a year. Expenses in general are paid periodically, while those that fall due at certain times of the year are "accrued," or set up as a liability until their due date arrives. These operating expenses may be classified as: (a) General expenses, (b) interest, (c) taxes.

The general or operating expenses include salaries of officers and employees, rent, light, heat, stationery, telephone, director's fees, janitor's supplies, advertising, and incidental items. These are paid monthly or oftener. As they are paid they are entered in an expense classification book, which classifies each item under its proper head, so that the total for each class may be known. Salaries are paid in cash, other expenses by cashier's checks.

In the larger banks a more elaborate system is used, employing the voucher check. Orders for supplies are on requisition by the proper officer. The requisition goes to the purchasing department, which places the order for the goods. This order is in triplicate, one copy going to the firm from which the goods are ordered, one to the expense clerk with the requisition attached, while the third copy goes to the receiving clerk as a check on the delivery. When delivery is made, a voucher card,

serially numbered, is made out. This card forms the journal entry, such as a debit to "stationery," for instance, and a credit to accrued expense—meaning an expense incurred but not paid. When the voucher card with its attached memorandum is approved by the officer in charge, the entry is made in the voucher register, and the card and its attached documents filed for record purposes. When the bill is finally paid, it is by cashier check, or voucher check of the same officer, which constitutes the bank's receipt. In making up pay rolls, requisition is made for the amount to be paid, and after auditing, it is cashed and the funds distributed and receipts taken from the various employees.

Vouchers are recorded in voucher registers, which serve as a journal from which postings are made in the general ledger. The voucher number, date, amount, to whom issued, are recorded. The total of the vouchers issued at a given time is a credit to accrued expense and a debit to the divisional expense account.

Interest Payments.

Inasmuch as the bank is constantly paying interest to its depositors, this account is an active one and runs into large figures. If the interest is due and paid, it is charged to "interest paid," but if the interest is not due, but accrued, it is charged to "interest accrued account," and in some banks, this item is charged up day by day, from estimates made. If interest is paid in advance, as in the case of a discount obtained at the Federal reserve bank, it is charged as "interest prepaid." Banks, like individuals, are at times obliged to borrow money, and in doing so they must pay interest or discount, depending upon the nature of the transaction. If the bank borrowed on its bond holdings with the Federal reserve bank, it would set up a continuing liability day by day, but if it

obtained a discount of its paper holdings, it would enter the amount as a prepaid item. When the books are closed, adjustments are made as the facts may warrant. Interest accrued becomes interest paid, and interest prepaid becomes interest paid, when time has brought the matter to a finish.

Taxes.

Taxes are paid on real estate owned by the bank, and on the bank's stock and note issues, and as income and excess profits tax. The taxes on real estate and stock and note issues can be approximated at the beginning of the year and a pro rata amount set up each month to cover. When the period for payment arrives, the amount is already provided for and is paid and charged to taxes, while the sums set up beforehand have been credited to taxes accrued and charged to expense. The income and profits tax, being more or less uncertain, can be provided for only by estimate, and the amount set up as before stated. The idea in mind is to show these charges as running constantly and not simply coming to a head at a certain time, an obvious error.

Cashier's Checks.

A cashier's check is the bank's order on itself. These instruments are used in various ways, such as in payment of bills against the bank, payment for collections made, investments, telegraphic transfers, and in many other ways where cash is not desired. They are often used in place of certified checks, and many banks issue them instead of certifying checks. In issuing cashier's checks "cashier's check account" is credited. As the checks are presented for payment this account is charged, and the item cancelled and filed for reference. The outstanding amount of checks as shown by the register must total the amount on the general ledger. Control of the

issue of these instruments is by number, and all must be accounted for.

Bank Drafts.

In many cases firms in cities other than New York, Chicago, etc., require "New York funds"—meaning a check on a New York bank—and the local bank is requested to issue such instrument. The customer's account will be charged, either from ticket, or preferably from the depositor's own check, and the correspondent bank's account is credited. These, too, are carefully safeguarded and all numbers must be accounted for.

The Cashier Account

In many banks a "cashier account" is operated through which are passed sundry items that cannot be debited or credited through regular channels. If cash or its equivalent is received and immediate credit cannot be given to any certain party, cashier account is credited and cashier's check is issued and held by the bank until the payment can be made. If a collection is made and is to be paid for by check, cashier account is credited and check issued to the customer.

Supplies.

Banks are large users of stationery and other office supplies such as typewriters, addressing machines, adding machines, and other mechanical labor-saving devices. Some banks are large enough to have their own printing department, and also have departments for ordinary supplies, stationery, printing and other duplicating departments.

Supplies are bought upon requisition signed by the head of a department. The requisition is then approved by the organization or operating department, and passed to the purchasing department, which invites bids or places the order.

Orders are made on two or more carbons, as the bank may elect, one copy going to the merchant, one to the delivery clerk to insure prompt delivery as to time, one to the accounting department for payment purposes, one to the stationery or supply department, and one to the receiving room

Supplies are delivered to the receiving room, where a delivery slip is made in triplicate. One copy goes to the voucher department as authority to pay, one to the purchasing department as evidence of fulfillment of the order, and one is filed in the receiving room

For the guidance of the officers and directors, statements of earnings and expenses are prepared, monthly or semi-annually. The earnings consist of interest and discount received, less unearned discount, accrued interest, rents, commissions, exchange, recovered charge-offs, and other sources of incidental income; while expenses consist of salaries, operating expenses, interest paid, light, heat, telephone and telegraph, etc. The difference represents the net income for the period under review

CHAPTER XVI

THE COMPOSITION OF THE GENERAL LEDGER¹

The general ledger contains an account for each asset and liability of the bank, and following the accounting rule that where a real asset goes out a nominal asset is set up, and where a real asset comes in a nominal liability is set up until the books are closed, we shall have an account for every phase of the bank's business. If, therefore, we analyze these accounts, and understand what they represent, and their purpose in the accounting scheme, we will have a summary of the bank's operations in all departments. At the same time we discuss the general ledger we analyze a bank statement, for this is but a transcript of the ledger, set up in different arrangement, but composed of the same elements. It will be the purpose of this chapter to take each account in the general ledger and show its meaning and the source whence it comes. The arrangement of the items is a matter of choice, but it will be found helpful to have the accounts in the same order in the ledger as they appear on the statement, thus making posting from one to the other more expeditious. The author prefers a loose-leaf ledger with balance column, debit and credit, with

¹ Rather than analyze the statement of a bank, the author has chosen to analyze the accounts in the general ledger. This book contains all accounts to be found in the statement, and such other accounts as expense, interest, taxes, overdrafts, exchange, protest, etc., as well as, in many banks, the accrued interest, unearned discount and customer's liability on account of acceptances, and the contra account, bank's liability on account of acceptances. This process will give the student a more comprehensive idea of the control accounts of a bank.

leather tabs indicating the accounts. The book can be built up as needed, rearranged if necessary, and dead matter eliminated. Any account can thus be found immediately without reference to an index, for the book is self-indexing.

The accounts which find lodgment in the general ledger may be created by direct postings from the daily journal, or assembled from subsidiary ledgers. The former would be the practice in a small bank, and the latter in a large one. It is immaterial from what source the items come, they represent the same thing as a general ledger entry. Therefore we will take a bank of ordinary size and ascertain what accounts are usually carried on its general ledger and the purpose of each.

Securities Account This account contains the bond holdings of the bank. They may be classified into public and private securities, public utility, rails, municipals, Governments, etc., for the purpose of showing the amount of the different classes held, or this classification may be made on a separate book, such as the bond register.

Bonds have four values: (a) Par or face value. This is the amount that will be paid at maturity by the debtor. (b) Market value. This will be the cost at the time of purchase, but varies with financial conditions. It is the price that could be realized on sale. (c) Book value. This is the holding value, or amount at which they are carried, and may be any one of the four values herein mentioned. (d) Investment value, which is the value based upon cost, allowing for amortization of the premium or discount. It is an accurate value, if based upon the theory that the bond will be held until maturity. Thus, if a bond were bought at 110, or \$1,100 for a \$1,000 bond, due in ten years, on a rough calculation the value at the end of the fifth year would be 105, or \$1,050,

meaning one-half of the premium has been taken out of the interest received. If it were bought at 90, or \$900, its value at the same time would be 95, or \$950, which means that one-half the discount of \$100 has been added to the cost, to bring it up to par at maturity. This process avoids taking a profit or a loss in any one year, and gives the bank the actual earning power of the bond as contemplated in the original purchase price.

But whatever the method pursued by the bank, the figures shown on the general ledger are the *book values*, and as a rule banks endeavor to carry their securities at their market value, thus showing the bank's position on a selling-out basis. But inasmuch as banks do not go out of business, the author prefers the investment value as the most practical and fair to all concerned.

Some large banks classify their bond holdings as follows:

U S Bonds deposited with Superintendent of Banks (for the purpose of operating a trust department)

Bonds to secure state deposits

Bonds to secure Postal Savings deposits

Bonds to secure circulation

Bonds to secure U S deposits (the Government deposits only with banks that deposit United States bonds with it)

Bonds to secure War Savings and Thrift Stamps

Bonds on hand

Bonds to secure loans from Federal reserve bank

Bank Building. The law does not allow banks to own real estate except as stated below, but it does permit them to own banking houses, and from those parts not required for their own use to obtain a revenue. Therefore banking structures adorn even the smallest villages. The figure at which the building is carried depends upon the viewpoint of the directors. Where it is a specialized structure, built for banking purposes only, it is carried at a

figure running from cost to a nominal value. If it is a commercial structure, it may be carried at a price that will show adequate return upon the investment, or cost, or appraised value for taxation purposes. It may also be carried at its market value, which may be above or below cost.

Other Real Estate Although a bank is not allowed to purchase real estate other than a bank structure for investment, it may take over property in settlement of debts previously contracted. Frequently debtors will turn over their property, or it may be taken under foreclosure, in lieu of settlement. The law allows the bank to hold the property for five years, during which time it must be sold, or an extension obtained from the supervising authorities.

Mortgages Prior to the Federal Reserve Act, a national bank was not permitted to loan on real estate, but the act now permits national banks in all but the central reserve cities of New York, Chicago and St. Louis to loan on mortgage security. Other banks may loan on property within 100 miles of the home office, for one year, and not to exceed 50 per cent of the appraised value, on farm land the loan may run for five years.

State banks, however, may loan freely upon such security, but as a rule on first mortgage security only. The amount in this item will represent the amount so loaned.

Collateral Loans These may be classified into time and demand loans, and represent the amount loaned upon collateral, which may be divided into as many groups as the bank may elect.

Demand Loans. These are loans on notes of hand, payable on demand and unsecured, sometimes called "demand bills."

Discounts These are the promissory notes discounted by the bank. They may be the direct obligation of the

makes to the bank, with or without an indorser, or notes taken by the bank's customers and discounted by the bank for their account

Due from Banks In this group there will be an account with every bank with which the bank does business. The banks which are depository banks will be segregated in order to show the amount carried with them as reserve each day. Other banks which are not legal reserve agents will also be separated, and where items are sent to non-correspondent banks, one account may be carried as "collection account" or "miscellaneous banks," which will include all collections that go outside the regular channels. The balances due from these banks will be assets, and if the balance is due from the bank to other banks, it will be a liability. All cash items sent out are charged to these accounts and all items received from them will be credited, throwing the balance in favor of or against the bank in question as the case may be. These accounts are reconciled monthly.

Cash This account represents the cash on hand and in the vaults, and which in all banks not members of the Federal reserve system forms part of the legal reserve. In member banks cash on hand is now optional.

Customers' Liability on Account of Acceptances To this account are carried those obligations of customers taken to secure the bank for acceptances made by it for their account. They may be in the form of notes, agreements, collateral loans, etc., but having assumed an obligation for a customer, it follows that the bank must have an obligation from a customer to offset it.

Due from Federal Reserve Bank. All banks that are members of the Federal reserve bank and such other banks as avail themselves of its privileges (See "Federal Reserve Bank") are required to carry their reserves with the Federal reserve bank. This is the only reserve

required of member banks All checks sent to the Federal reserve bank will be charged to this account, and reversely checks received from them will be credited The balance shown is the amount *due from the Federal reserve bank*

Federal Reserve Bank Stock All banks, members of the Federal reserve bank, are required to invest 3 per cent of their capital and surplus in the stock of the Federal reserve bank This item represents such investment

Five per Cent Fund Due from U S Treasurer This is 5 per cent of the amount of circulation taken out and is kept with the Treasurer at Washington To this fund new notes sent to the bank are charged, and worn and mutilated notes are credited It is really a cash balance with the Treasurer used as a clearing house for notes issued This applies to national banks only

Exchange for the Clearing House These are the checks that will be presented the next day for payment through the clearing house

Checks on Other Banks in City These are checks to be collected by messenger

Overdrafts An overdraft, being a loan without security, comes in the same category as discounts As a rule overdrafts are not carried in the general ledger, but are listed in making up statements for publication in order to show the amount so advanced In the daily proof they are deducted from the total balances, but in making up the statement they are added to the total due depositors, to offset their entry on the asset side

Furniture and Fixtures—It is the custom in many banks to charge such articles as adding machines, typewriters, desks and other equipment to furniture and fixtures, and gradually reduce the amount by charging off each year a proportionate amount At best these articles are a slow and often a negligible asset and should

be carried at a nominal figure only Many banks do not carry them at all

Nominal Asset Accounts

It is, as before stated, a rule of accounting that when an asset goes out, something must be set up in its place until the books are closed For instance If an expense, interest, tax, etc , is paid, cash or its equivalent goes out of the bank, and to represent the cash outlay, an expense, interest, or tax account is charged to keep the equilibrium of the balance sheet On the other hand, if cash comes in for interest, a nominal account is credited to represent the increase, and so *interest* is credited. Therefore we have as nominal asset accounts

Interest Paid. To this is charged all interest paid on daily balances, certificates of deposit, savings accounts, and for borrowed money. This item also may be split up into groups to represent the amount paid on each class.

Rent. If rent is paid for the banking rooms, this account holds the rental paid from month to month Rent received from other real estate and safe deposit boxes is a credit and found under liabilities

Expense. This is the general expense account of the bank. To classify the expenses on the general ledger would involve too much detail for a book of control, therefore the totals only are entered here, while the details are carried to an expense classification book, which shows each class of expenditures The total of these must agree with the ledger control account

Insurance This is the insurance on the bank premises, burglary, liability, surety bonds, and all forms of insurance

Exchange. Exchange paid is charged to exchange account and exchange received is credited, and the

account is an asset or a liability depending upon whether the bank receives or pays a surplus of exchange.

Commissions Such expenditures may be treated either as an expense and so classified, or as a separate item. Commissions arise from collection of rents, sale of securities and other services compensated for on a commission basis.

Accrued Interest.

It is a rule of accounting and of law that accrued interest must be considered an asset and so set up in financial statements. This term, sometimes vague to the layman, is simplicity itself. Interest has been defined as "the increase in a debt due to the lapse of time." The debt, therefore, is constantly increasing. Let us apply the definition to a particular end. Here is a bond of \$1,000, held on the books at the same figure, with interest 6 per cent payable January 1 and July 1. We are taking off a statement as of April 1. It is obvious that the bond is worth more than \$1,000, inasmuch as it has earned for us three months' interest, or \$15. We might list the bond at \$1,015, but a better way is to set up an account and call it "accrued interest"—meaning that part of the coupon that is earned to date but cannot be collected because not yet due.

In purchasing securities, the buyer pays a proportion of the unpaid coupon, and the seller receives the same amount, the former reimbursing himself when the coupon is due and paid. The seller therefore receives interest for the full time the bond was his, and the buyer receives interest for the time he holds the instrument, and both receive that which fairly belongs to them.

Some banks figure each day how much interest the bank has earned for the day and carry it to "accrued interest," while others do so only when making up re-

ports for the authorities. This, of course, requires considerable work and must be carefully done.

Where the interest is not figured from day to day, so that the accrued interest is known at all times, a very simple way is to compute the interest on each block of bonds for one day and set it down on the bond register. When a report is made up, it merely requires that the amount be multiplied by the number of days since the interest on the block was due and paid. Thus, on a block of bonds with interest due January 1 and July 1 (with \$1.66 as the interest for one day), if a report were called for on September 1, the interest accrued for this block would be $60 \times \$1.66$, and so on for the total holdings.

Suspense. This account holds past-due paper, notes that are doubtful, or slow of collection, and in many cases notes which have been charged off as uncollectible and held at \$1 each, in order to keep them alive. A "suspense ledger" is sometimes used to detail in full the history of paper which has been turned over to the attorney for collection, "charge-offs," etc. Frequently banks are enabled to collect old obligations that have been charged off, and these collections are credited to profit and loss, and in order to trace the procedure from time to time the details surrounding such items are entered in this book. It is the control ledger for the suspense account on the general ledger.

Taxes. Banks pay taxes of various kinds, namely Tax on income, tax on capital, tax on circulation (national banks only), and real estate taxes on property owned.

Since the advent of the income and excess profits tax, banks have been large contributors to the public purse. And inasmuch as the profits of a bank are more or less stable, the amount of tax can be estimated and

provision set up from month to month to meet the tax when due

Tax on Bank Shares Under the Federal and state statutes bank stock is assessable as personal property of the owners. As a general rule this tax is paid by the bank. Each bank reports to the local taxing authorities the names, number of shares, addresses, capital, surplus and undivided profits at a stated time. The assessors then make the assessment in the district where the bank is located. This tax is usually 1 per cent of capital, surplus and profits. While the bank is regarded as the agent of the stockholder in collecting this tax, it is paid by the bank, and no further action taken, except, it may be, to notify the stockholders of the amount paid by the bank for their account, as a deduction in making their income return.

Tax on Note Issues. National banks are required to pay a tax of one-fourth of 1 per cent. on the average amount of notes outstanding, secured by United States 2 per cent bonds, and one half of 1 per cent. on the average amount of circulation secured by other United States bonds (not Liberty Bonds, which are not eligible for circulation purposes). Ten days after the first of January and July, report of the average circulation must be made for the preceding six months.

National banks being citizens of the state in which they operate, and other banks essentially so, the state permits the local taxing authorities to tax their real estate holdings the same as that of any other property owner. The amount of the taxes can be estimated at the beginning of the year and each month a proper proportion charged to taxes paid and credited to taxes accrued, or reserve for taxes, thus distributing the charge over the entire year, and not making it a single charge.

Teller's Differences In the work of the tellers, errors will occur that cannot be adjusted except through book entries. These are made to "teller's difference account," which holds the "overs" and "shorts." To this all shortages are charged and overages are credited. Some of these entries are afterward offset by discrepancies discovered in balancing the accounts, but a great many are never located and become profits or losses as the case may be.

Liability Accounts.

Capital Stock This account does not change from day to day, as do others, but remains fixed. It represents the amount of capital paid in at par, which capital must be the amount required by law for a bank in the particular locality. National banks may organize in country districts with a minimum capital of \$25,000, while in some sections state banks may operate on as low as \$15,000 (see under "National Banks").

Surplus Fund This fund is, at the beginning of the bank's existence, contributed by the stockholders as an additional safeguard to depositors, and as profits warrant it is increased from time to time. It is the aim of every well-managed bank to create as large a surplus fund as possible. It not only shows the world that the bank is well protected but that it is ably managed, for profits accrue from wise management. This fund also remains stationary except as additions are made out of profits. The fund makes the stock the more valuable, for the reason that upon liquidation the surplus would belong to the stockholders. A bank with capital of \$100,000 and surplus of the same amount would have a book value of \$200 per share, at the least. Included in the surplus should be

Undivided Profits. This is the "cleaning house" for the other accounts. To it are carried the gains of the

business, and from it are subtracted the charges and losses. An unusual item of profit, such as from a sale of bonds, would be carried to undivided profits, and a loss, such as on a worthless note, would be charged to this account. In many banks the adjustments with depositors are made through this account.

When the books are closed at the end of the fiscal period, usually June 30 and December 31, such items as rents received, interest received, etc., are credited to profit and loss, or undivided profits; while expense, interest paid, taxes, etc., are charged, the difference being the net profit for the period.

Deposits These have many subdivisions, first into classes and then into groups for ledger classification, such as (a) demand deposits or checking accounts, grouped if desired—these are the balances due depositors on their checking accounts, (b) savings accounts, (c) certificates of deposit, (1) demand, (2) time, (d) Christmas club, (e) postal savings funds (funds deposited by the local post office arising from the Postal Savings deposits), (f) deposits by the United States and other public deposits, usually secured by pledge of bonds, (g) certified checks outstanding. Inasmuch as a certified check is a demand obligation of the bank, it is treated as a demand deposit, but separately listed to indicate how much in certified checks is outstanding.

Cashier's Checks This is a liability, for the reason that the bank has agreed to pay the amount to the payees named in the checks issued in this form. If funds have been received in exchange for the check or if assets of any kind are taken into the bank for which a cashier's check is issued, they would offset the charge here made and be held as an asset. If cash were received in exchange for a cashier's check, cash would be debited and cashier account credited.

Cashier's checks are used for many purposes, such as paying the expenses of the bank, purchases of bonds, payments for collections made which are not credited to customers, and all forms of obligations which the bank wishes to settle by drawing its own check. The cashier's check is used in many banks in lieu of certification. When a check is offered for certification, the check is taken up and a cashier's check issued in its place.

The practical use of cashier's checks and their profitability will be seen from example. A bank in Poughkeepsie, New York, contracts to purchase a block of \$10,000 bonds, payment to be made on July 1. On that day they are delivered with accrued interest to date. The bank sends in payment a cashier's check on itself. This does not draw upon its cash reserve in New York, upon which it receives interest at 2 per cent, being merely its own order on itself. The seller accepts it and deposits it in a New York bank on the second of July. It comes back to the Poughkeepsie bank on the third, and is paid by drawing a draft on its New York correspondent, which is presented on the fifth, at which time interest ceases to run on the amount represented thereby. The Poughkeepsie bank has had interest on its bonds for five days, and also interest on its New York balance for the five days, giving it double return. This is a banking secret. Guard it as such!

Certificates of Deposits All banks issue certificates of deposit, which are evidences of deposit and are payable either on demand or at a stipulated time. They are in the nature of time deposits drawing interest, and are used in place of savings pass books. The latter are issued upon standard rules such as are in force in savings banks, while the certificate of deposit is an elastic document and carries whatever interest the parties agree upon. They sometimes carry interest from date to day of withdrawal,

and in other cases interest only if left for a stated time. Demand certificates do not as a rule carry interest. The time certificate is used for investment purposes. The return of the certificate is mandatory, and the bank records the details of the certificate in a certificate register and also a certificate ledger, which must be in balance with the general ledger. Part payments are recorded on the back of the certificate.

Discount. *Discount*, as distinguished from *interest*, consists of funds received through the discounting of notes. Such accretions are credited to discount, and this account represents all the bank receives from the practice of discounting.

Interest Received This includes interest from investments, mortgages, balances with other banks, demand loans, and all other earnings that would come under the head of interest. It is one of the bank's principal sources of income.

Rent If the bank receives rent from its real estate, it is carried in this account.

Due to Banks If the bank has received cash items from other banks for which payment has not been made; or if there is an open account and the bank is debtor, it will show as an amount "due to banks."

Circulation Outstanding All national banks issue their national bank notes, which are a liability of the bank. These bank notes are promises to pay and should be held as a liability, and so set up in the ledger to show the amount outstanding at all times.

Protest Account This account is credited with the protest fees received from the protest of unpaid items. Some banks delegate this work to an officer or to a notary who receives the fees, in which case the income does not become part of the bank's receipts, but where

the protesting is done as part of the bank routine, the income therefrom accrues to the bank's profit

Reserves. As has been stated elsewhere, taxes, and other fixed charges that are payable at stated times during the year, are best cared for by setting up an account to which is carried each month the proportionate amount of the yearly sum. The approximate amount is figured at the beginning of the year, and each month one-twelfth is carried to reserves for taxes, etc., so that by the time payment is made, they will have been provided for. These charges, like interest, grow constantly, and to conclude that they become a charge on the day they are due is to forget that time is doing its perfect work in bringing these items to maturity

Interest Accrued to Depositors. As the bank has interest running in its favor day by day, so it has interest running against it day by day. The interest on deposits of all kinds is constantly accumulating, and unless this is acknowledged, the bank will be deceiving itself by denying a debt that exists

To illustrate. The bank has savings deposits of \$2,000,000 on which interest is paid twice a year. It is now April 1. It is apparent that its debt to depositors is not \$2,000,000, but \$2,000,000 plus interest for three months. From previous experiences, the bank can approximate the interest cost on such accounts, which is set up under the title "accrued interest due." Or, better, this account is charged daily or monthly with the growing accretions of interest running against the bank.

Bank's Liability on Account of Acceptances. When a bank assumes the burden of paying an acceptance for a customer, as elsewhere discussed, it must show this liability as existent. To do this, an account is carried under the above title, to which is added each acceptance taken on, and the amount in this account is, as a rule,

exactly the same as in "Customer's liability on account of acceptances," *contra*

Unearned Discount When a note is discounted, the interest for the full time is deducted immediately and the proceeds turned over to the borrower. The income thus received is treated, in many banks, as an earning, without consideration of the fact that the interest so received is really earned day by day and is spread over the life of the note. If a \$1,000 note were discounted October 1 for three months, at 6 per cent, the interest would be \$15, which, under ordinary practice, would be credited to discount account immediately. If we were to take off a statement as of November 15, it follows that only half of the \$15 belongs in the period prior to that date, and the other half belongs in the subsequent period. All well-managed banks take cognizance of these facts and do not consider as earnings anything that is not realized during the period under review.

This may be accomplished in several ways, one of which is to credit such earnings to "unearned discount," and once a month the actual interest earned is charged to unearned discount and credited to "interest received." A more simple way, although not giving the bank a running account of this matter, is to compute the unearned discount when reports are made up.

A simple method is to take the maturity tickler and make a total of the notes due each day. If, for instance, there is \$50,000 due on November 16, using the date of November 15 as the date of report, it is apparent that we have taken one day's more discount on \$50,000 than should be allowed for the period prior to November 15. On November 17 we find \$20,000 maturing. On this we have taken two days' more interest than is allowable, and so on through to the last note falling due. The interest on the various amounts for the respective

days will make up the unearned discount, which in reports shows as a liability, or in other words a deduction from earnings up to the point in question.

Banks handling discounts in large volume will have a large amount of unearned discount, and unless it is stated in reports and estimates of earnings, the officials will be deceived. In one large New York bank the unearned discount shows about \$300,000, and if it were not stated, the bank would constantly show undivided profits that are much larger than they really are. A very simple way, for estimating purposes only, is to take 45 days' interest on the total discounts, which will ordinarily be approximately correct.

Unpaid Dividends When a dividend is declared, the amount is credited to dividend account, and checks equal in amount are sent to stockholders. As they are returned for payment they are charged to this account, and the difference represents checks still outstanding.

Bills Payable—Rediscounts These accounts represent the amount of money the bank has borrowed. Many banks find that they have more calls for funds than there are funds to loan, or they may have overloaned, or their depositors may be reducing their balances faster than loans are maturing or deposits coming in, and so they borrow from their correspondent banks or rediscount some of their note holdings with the Federal reserve bank. If a loan is desired, the bank will take Government bonds to the lending bank or to the Federal reserve bank and obtain a collateral loan, thus placing it in funds, precisely as an individual would obtain a loan from his own bank, or it might take some of the notes it has discounted and rediscount them at the correspondent bank or the Federal reserve bank, just as a merchant would take the note of a customer and discount it and add the proceeds to his balance. This practice assumed

large proportions in 1919 and 1920, some banks borrowing or rediscounting upwards of a hundred million with the Federal Reserve Bank of New York.

Statement Book.

The statement book is in reality a trial balance of the general ledger. When the posting on the general ledger is complete, the balances, without reference to whether they are debit or credit, are carried to the statement book on the proper side, and the total of the two sides must agree, otherwise there has been error in posting from the journal sheet, or in taking the balances.

The daily statement must not be confused with the statement which is published periodically by all banks. The published statement has taken from it all nominal assets and only real assets and liabilities are stated. The books are theoretically but not actually closed as of the day on which the statement is made. (See "Audits and Examinations.")

CHAPTER XVII

AUDITS AND EXAMINATIONS

By virtue of the fact that a bank handles thousands of transactions in the course of a day or a month, the work must be in proof constantly, and checks and counter checks made upon the work to insure accuracy and safety of assets. For this purpose we have *audits* and *examinations*. An *audit* merely verifies the accuracy of entries, an *examination* verifies possession of assets and the amount of liabilities outstanding. A *report* sets forth the results of the examination.

By law and good practice banks are audited both from within and without. The New York Law requires that the directors examine the bank twice each year, and many states have the same requirement. Also, there are examining departments for both National and state banks which, at least twice a year, make a test of the bank's affairs by bank examiners. In clearing house cities there are clearing house examiners, while in many banks public accountants, who as a rule do their work with great care and thoroughness, make periodical audits of the entire bank by direction of the directors. This takes the place of the directors' examination, which as a rule is perfunctory only. A bank director is not by nature a bank auditor.

The Auditor.

Banks with assets of five millions or more find it necessary to employ an auditor, and the larger banks have auditing staffs, whose duty it is to verify various

departments of the bank's work. This verification consists in a daily check upon the work of the bank, as received from the different departments. These checks consist of records sent to the auditor that are independent of the source of origin. If one department issues a cashier's check the duplicate will go to the auditor to be by him checked with the payment thereof. One department will authorize the payment of a bill, while the auditor will check the payment.

The auditing department will examine the various departments of the bank from time to time as the bank examiner examines the whole bank. It will examine the loans and bond holdings, prove the depositors' balances, outstanding certified checks, etc., and in fact check the work of each department by reconciling the total with the control accounts.

This department also reconciles the accounts with correspondents and with depositors, and where the bank operates branches, will act as auditing body over the work of the branches, and also over their accounts with the head office.

In departmental banks, one department acts as a check upon the other. Thus the statement department acts as a check upon the bookkeepers' work. The check desk will act as a control over the bookkeepers, and the department receiving work from the receiving teller acts as a check upon his work. Thus the receipts must equal the total of the deposit tickets, and the one acts as a check upon the other.

In many banks the auditors appear at uncertain times and check the work for a few days, just as bank examiners appear at unexpected times and examine the bank. It is found in practice that an audit that *may* be made at any moment is a much stronger impetus to good work than the knowledge that an audit will be made at a cer-

tain time, or that a continuing audit is being made at all times. Some banks accomplish the same result by changing the force around from time to time, thus giving the men experience in various departments of the work and at the same time making wrongful practices dangerous

Safeguarding Cashiers' Checks.

The issue of cashier's checks and such instruments is protected by having the blanks in the hands of the auditing department, which issues the forms to various departments, under a serial number indicating the department receiving the same, and charges them to the department on sheets. As the stubs or duplicates are turned in they are taken off the list and all numbers must be accounted for, either by having been issued or by return of the unused form. The stubs are checked with the originals by number and amount, etc., and wrongful use of these is prevented. The paid checks are compared with the book entries, and the outstanding amount must agree with the unchecked stubs or duplicates.

Shipment of Valuables

Shipments of valuables are safeguarded by comparing with the shipping slips, to see that they are properly addressed, and the receipts returned to the bank are checked with the original records to see that the package reached its destination and the right party. Registered mail is sent out from a shipment book, with return card, which, upon return, is compared with the shipment book to verify its proper delivery. Shipments unreceipted for are followed up through the post office department.

Customers' Reconcilements.

All banks endeavor to reconcile their accounts with customers as often as once each month, and in dealing with correspondent banks this is the fixed rule. State-

ments are sent out showing in detail each transaction that went through the account, with voucher or ticket to correspond. These reconciliation sheets are compared with the customer's records, and if error exists its prompt report is requested. If the account is in agreement, acknowledgment is made by the authorized person, and this acknowledgment is compared with the bank's records to see that it was made by one so delegated to act. Where errors occur they are corrected as speedily as possible, and every means is used to keep the accounts in agreement. Correction tickets for errors discovered by the auditors are made by the department, and record kept of the same.

Bank Examinations.

It is required by both state and Federal laws that the banks be examined by regularly appointed examiners, as a rule twice each year. These examinations are made without previous notice, but the time can be approximated within a month or two. Often they are made more frequently if the bank is considered as requiring more frequent audits.

Scope of the Examination.

The procedure in making such an examination is as follows. The vaults, security chests, files containing collateral loans, files where the notes are kept, and in fact all the assets, are taken under control of the examiners, who place their seals upon such files and vaults. The cash is verified first, and usually the examiner appears at the close of business, or before the opening of the doors, in order that the business of the day be not retarded unduly. The counter cash is verified first, and afterward the reserve cash. The securities are compared with the book records, and the number of bonds in each

class must be produced. The total of the book values must agree with the control account. The notes are then totaled and must equal the amount shown in the discount item on the statement. These are usually in three classes, discounts, demand loans unsecured and collateral loans.

Each collateral loan is examined to see that the collateral is as stated and in proper form and the margin sufficient to cover the loan. Real estate held must be evidenced by deeds running to the bank. Mortgages must agree with the "mortgage loans" in the statement, and each must have the bond, mortgage, appraisal, insurance and title policy or search.

The amounts due from other banks are verified by communication with the debtor banks, and a statement, as of the day of the examination, is called for, with vouchers, for reconciliation purposes.

The above will account for all assets, with the exception of nominal assets which are eliminated.

Any asset held outside the bank, such as notes out for collection, or bonds held for safekeeping in other banks, or held by public authorities as security for deposits, must be evidenced by proper receipt.

In some jurisdictions, a card record of all loans is made for use in the banking department, and these cards are brought down to date at each examination. In fact, each line of credit is investigated to see that it is within the law and conservatively extended. Each note from its entrance into the bank to its exit is traced by means of these card records, which set forth the borrower, collateral, line of credit, analysis of his statement and sometimes average balances.

The liabilities of the bank are tested by trial balances of the depositors' accounts, and all forms of liability shown are tested by the trial balance process.

The cashier's checks are verified with the check register, and unused or outstanding checks must be accounted for.

The outstanding certified checks and certificates of deposits are also proven with the records.

The stock certificate book is checked with the stock book to ascertain that all stock is outstanding.

The minute book is examined from the time of last examination.

When all assets have been accounted for, and all liabilities proven, the examiner's work is done, with the exception of computing the market value of the securities and making up his report and recommendations. This work is done in the office of the department, and in due course the bank will receive a letter and transcript of the examiner's findings.

In many cases, where the audit is extensive, the loans are verified by sending the borrower a memorandum of the amount standing against him, and in collateral loans, a list of collateral is also given; and he is asked to verify the same. Likewise depositors' balances are proven by sending to the depositor a statement of his balance with reconciliation which goes to the examiner direct.

A clearing house examination or one by a public auditor will follow the same general lines, the completeness depending upon the efficiency of the examiner.

The Bank Examiner

In approaching a bank with powers of an examiner, one of two courses may be taken. First, an examiner may assume an attitude of helpfulness, and a desire to show the bank in the best possible condition consistent with the facts, or, second, he may approach as a detective, seeking for destructive information. The examiner can immediately secure the good will of the officials, or he can soon engender a spirit of opposition.

The bank man who knows his bank is sound and well managed dislikes to be criticized for the things with which he is most conversant. He dislikes having a loan which will stand every test of a good credit man criticized because the examiner does not know the personal equation. In every locality there are peculiar conditions which a bank must meet, and there are certain men who must be dealt with in a way that will create good will, and only by living with the customer from day to day can his peculiarities be known and his wishes catered to. It is easy to destroy, it is hard to create. Because one bank man goes wrong is not to say that all are going in the same direction.

That examiner succeeds in the highest sense whose attitude is helpful, thoughtful, constructive, kind, but firm, and who knows banking as a fine science and an everyday practice. Even a novice might assume to criticize the Bank of England, but only a trained and experienced banker could run it.

Bank Statements.

At least five times a year under the National Banking Act, and usually at least quarterly in other banks, the authorities call for reports. These are usually dated a few days back, in order to prevent "window dressing for an occasion." These calls are sent out without warning, though they too may be approximated, but at times there will be two reports called for during a short interval, to prevent any attempt to "clean house" before an expected call.

The blanks are sent to the bank with the call, but usually the notice is published in the papers by advice from Washington or from the state capital. The banks will therefore know of the call as soon as telegraphy can spread the news. Upon such an occasion the force of

bookkeepers immediately begins work to compile the figures, and in the larger banks the work is ready for the press in a few hours, everything being in readiness for such a call. In the smaller banks, the work of assembling the figures rests with the cashier and assistants, who must prepare much original matter from the books of record. The accrued interest and unearned discount require the most time, but even these items may be ascertained without undue effort if a few simple rules are followed, one of which is to keep the maturity book footed, and as for accrued interest on bonds, a following of the rule on page 234 will be found helpful.

Publication of Reports.

The law also requires that the statement of condition be published in a newspaper circulating in the locality where the bank operates, for the information of the public. So rapidly do some banks work that upon receiving a call for report in the morning, the published advertisement will appear in the evening. Reports must be filed within a certain number of days after the call.

CHAPTER XVIII

BANK ORGANIZATION AND ADMINISTRATION

Administration.

The general policy of a bank is under the control of the stockholders, who by the voting power of the stock held, dictate the character of the management. They elect the directors, and any change in the management must be brought about by a change in the directorate.

The Directors

The board of directors is the ultimately controlling body of the bank. It is responsible to the stockholders for profits, and to the supervising authorities for keeping the bank within the law and sound banking practices. It is required to know the law and see that it is obeyed. It is required to know what loans and investments are made, and in some states, notably New York, all loans and bond investments over \$1,000 must be reported to the directors at the next meeting.

The board is required to meet monthly, receive reports, adopt policies, and pass on the general operating details of the bank. All communications from the supervising authorities must be read before it. It determines the amount of dividends to be paid and is the court of last resort in all matters affecting the management of the bank.

The stockholders must hold annual elections at the appointed time for the purpose of electing directors. In elections a majority rules, but in special matters, such as the merging of the bank with another, a two-

thirds vote is necessary. The qualifications for directors will be discussed under the appropriate title subsequently. Directors receive a stated fee for attending board and committee meetings.

In securing a loan from his own bank, a director is not allowed to vote and the matter must have the sanction of a majority of the board exclusive of the beneficiary of the motion.

Directors are required to use reasonable care and diligence in the management of the bank, and for laxness, resulting in losses to the stockholders, may be and have been held accountable.

From the directors are selected the various committees, the most important of which is the

Executive Committee.

This committee, sometimes called the discount or loan committee, meets daily, weekly or monthly for the purpose of passing on loans. It acts between meetings of the board, receives applications for loans and determines the general loaning policy. In most instances the committee establishes the line of credit granted to borrowers and accepts or rejects the various requests for loans, therefore through it the loan function of the bank is performed.

It is sometimes the rule to allow the officers to make loans up to a certain amount without reference to the committee at the time, to be accepted or rejected later by it. This committee, or one termed the "investment committee," selects the bond holdings of the bank. There is also the examining committee which makes the periodical examinations and audits, and such other committees as the by-laws may provide for.

The President.

The president is elected by the board from its members. His office may be honorary or executive. He is the

operating head of the bank, presides at the board and committee meetings, and is presumed to have oversight of its general operations. Where the position is honorary, he is simply a presiding officer, given the honor because of his standing in the community in order to lend dignity and distinction to the institution.

In the large banks he is the real head of the bank. He dreams its dreams, sees its visions, thinks out its problems and promotes its welfare. He it is who effects consolidations with other banks, and builds up an organization that reflects the spirit and the ambition of the bank. He plans campaigns for business extension, conceives new avenues for growth and expansion, and handles the large problems that come into the bank for solution. He is placed on committees of the various bankers' associations, and represents the bank in business and banking organizations. He makes addresses and moulds public opinion. He is a publicist as well as a banker.

The Vice Presidents

The vice presidents, of whom there are usually more than one, may be simply under-presidents, having the powers of the president, to represent the latter when he cannot function. Frequently it is an empty title carrying no great responsibility and little prestige.

But in many large banks, the vice presidents are real executives. They have distinct functions, such as being credit men for certain territory. They have exact duties, such as passing upon loans, buying securities, obtaining new business, and supervising certain departments of the work. They are sometimes business executives, brought into the bank to oversee the business of a particular line with which they are familiar, such as hardware, dry goods, automobiles, produce, etc. They

not only bring new business through the associations produced by former connections, but pass upon the credits in their respective lines.

In the large banks they are given a certain territory or trade to develop. They are acquainted with the business concerns in their territory and are expected to secure all desirable business that their district affords. They are combinations of credit and publicity men, to secure and hold new business. They secure deposits, make loans and promote the feeling of good fellowship between the bank and its customers in their jurisdiction.

The Cashier.

In many banks the cashier is the dominant force, and in all cases he is the technical head of the institution and is responsible for the smooth working of the accounting machinery. By virtue of long service in the one office, he is in many cases looked upon as "the bank" and is allowed a free hand in the management of its affairs.

His special duties are to act as secretary at the board meetings, keep the minutes, sign the checks and drafts of the bank, answer the correspondence, receive applications for loans, make reports, and sign the bank notes (national banks). He must be an accountant and understand the technique of bank operation so that every process is familiar to him. In fact, he should be able to go into any part of the bank and do the work with perfect ease.

Assistant Cashiers.

For want of a better term we have assistant cashiers, although the designation is not favored by many bankers. But inasmuch as, in the large banks, several assistant cashiers are necessary, there would not be separate titles enough in the banking vocabulary to go around.

In the small banks the assistant cashier may be a teller,

head bookkeeper, or auditor. In the larger ones he will have distinctive duties. One of the assistant cashiers will have general oversight of the bookkeeping, another will have custody of the Liberty Bonds, another will be in charge of the collection department. In fact, the department heads are usually assistant cashiers, and have the power to sign cashier's checks and initial tickets for book entry. Some of the large banks have upwards of a dozen assistant cashiers in charge of the various operations of the bank.

Auditor.

The work of the auditor is discussed under "Audits and Examinations," and need not be repeated here.

Comptroller

The comptroller is the disbursing officer of the bank, charged with the duty of paying the bills, auditing the expenditures, making up pay rolls and acting as treasurer of the institution in so far as control of the bank's costs of operation is concerned.

Chief Clerk.

The chief clerk is head bookkeeper. He has charge of the books of control, makes up the reports, reconciles differences, adjusts claims, audits the work of the general bookkeeper, and is responsible for the accuracy of the bookkeeping work. He is the accounting head of the bank, and from this position come many cashiers.

Bank Organization

The procedure in organizing a bank usually is as follows:

- 1 The enlistment of sufficient support from leading citizens to give the movement standing in the community
- 2 The selection of the men who are to form the organizing body
- 3 Inasmuch as the amount of capital is based upon the population, the requisite amount of capital should be ascertained at the incep-

tion of the movement, in order to know the amount involved in the sale of the stock

4 Organization application Reservation of name

5 Execution of Articles of Association

6 Execution of organization certificate In the meantime the stock will be offered for sale through the organization committee, and subscriptions received The subscriptions may be made payable in whole or in installments as the case may be, and proper subscription blanks should be used to make the application binding Care should be taken in awarding the stock that charges of favoritism do not arise by reason of preferential allotments, thus throwing the control into a few hands, and involving the bank in a controversy in the very beginning

7 Election of Directors

8 Organization of the Board and election of officers In the meantime the selection of the quarters and purchase of equipment will have been under way As soon as the cashier is selected, he will begin to shape up the bookkeeping system, which work should be passed upon by himself

9. As soon as the proper amount of stock is paid in, in cash, and authorization certificate is received, the bank may open for business

10 If a national bank, the stock of the Federal reserve bank must be subscribed for at this time

11. The collection of outstanding stock subscriptions will follow according to the prearranged plan

The National Bank Act.*

The National Bank Act was approved June 3, 1864, and controls the operation of approximately 8,100 banks, the largest number of banks under a single-headed control in this country

The chief supervisory officer of national banks is the Comptroller of the Currency, who is under the jurisdiction of the Treasury Department. He is appointed by the President, on recommendation of the Secretary of the Treasury, and confirmed by the Senate. The

* This chapter contains a digest of such parts of the National Banking Act as the student should know in order to have a working knowledge of bank organization and administration

term is five years. He is also ex-officio member of the Federal Reserve Board.

There are under his direction the usual deputies and office staff.

Neither the Comptroller nor a deputy may be interested directly or indirectly in any national bank.

The Comptroller makes an annual report to Congress covering various phases of national bank operation, statistics, etc., and recommendations.

Organization

National banks may be formed by not less than five men, who enter into *articles of association*, stating the object of the association, which must be signed by the organizers. Copy of this instrument is forwarded to the Comptroller's office.¹

An *organization certificate* is then made out, which states

- (a) The name of the proposed bank
- (b) Place of operation
- (c) Amount of capital stock and number of shares
- (d) Names and residences of shareholders and number of shares held by each of them.
- (e) That the certificate is made with the intent to form a national bank.

This certificate must be indorsed by three public officials and acknowledged before a judge of some court of record or notary public, and transmitted to the Comptroller.

Upon so doing, the organizers have the power.

- (a) To adopt and use a seal
- (b) To have succession for 20 years, unless sooner dissolved, or unless the franchise becomes forfeited

¹ Forms and complete instructions are furnished by the Comptroller's office. These must be carefully followed.

- (c) To make contracts
- (d) To sue and be sued.
- (e) To elect or appoint directors, officers, and clerks, define their duties, require bonds of indemnity, dismiss them and appoint others.
- (f) To adopt by-laws
- (g) To exercise such powers as shall be necessary to carry on the business of banking, discount negotiable instruments, receive deposits, buy and sell coin or bullion, loan money and issue currency

But no bank shall transact any business except such as is incidental and necessary to its organization until it has been authorized by the Comptroller to begin business.

Authorization to Begin Business.

When the Comptroller is assured by proper investigation that the bank has complied with the law in respect to organization and payment of its stock, he shall issue authorization to begin business, commonly called the *Charter*, which certificate must be published in some newspaper in the city or county where the bank is located for at least sixty days next after the issuance of the same. Business may be begun immediately after the bank is officially notified that the certificate has been issued

Capital

National banks must have capital as follows

- \$25,000 in places whose population does not exceed 3,000
 - 50,000 in places whose population does not exceed 6,000
 - 100,000 in places whose population does not exceed 50,000
 - 200,000 in places whose population exceeds 50,000¹
- Shares must be \$100 each

¹ Banks organized in suburban districts included in the political boundaries of a city must have the same capital as required for a bank in the city proper.

Payment of Capital Stock.

At least 50 per cent of the capital must be paid in cash before the bank shall be authorized to begin business, the balance in installments of at least 10 per cent on the whole of its capital, monthly, from the time of authorization to begin business. This makes the balance of the stock payable in five monthly payments.

The capital stock may be increased by consent of the Comptroller, and with the affirmative vote of two-thirds of the stockholders. Reduction not below the minimum provided by the act may also be made under two-thirds vote of the stock.

Guardians and trustees may subscribe to stock upon showing proper authority. Administrators have no authority to subscribe to stock, neither should stock be sold to municipalities.

Lodges and other associations may subscribe, if properly authorized, and if they are legally and financially able to bear the stockholders' liability.

Shareholders' Liability

Stockholders are liable individually for the debts of the bank to an amount equal to the par value of the stock held by them in addition to the amount invested in such shares. Executors, administrators, guardians or trustees shall not be personally liable as stockholders, but the estates and funds in their hands are liable to the same extent as the principal would be if living and competent to act and hold stock.

Voting Powers.

Each shareholder is entitled to one vote for every share of stock held, and voting by proxy is authorized, but no officer, clerk, teller, or bookkeeper of a national bank may act as proxy, and no shareholder whose liability on stock subscription is past due and unpaid

shall be entitled to vote. A director has been held to be an "officer." A copy of the list of shareholders must be kept up to date and also be sent the Comptroller on the first Monday of July in each year.

Directors.

National banks must be managed by not less than five directors (but as many more as the by-laws may provide for), who shall be elected by the stockholders at a meeting to be held before the bank is authorized to commence business, afterward at annual meetings to be held in January, usually the first Tuesday after the first Monday. Directors hold over until their successors are elected.

Directors must be citizens of the United States during their whole term of office, and at least three-fourths of the directors must have resided in the state, territory or district in which the bank is located at least one year immediately preceding their election and must be residents therein during their term of office.

Every director must own, in his right, at least ten shares of stock, unless the capital of the bank be \$25,000, in which case he must own five shares to qualify as director.

Any director who ceases to own the required number of shares is disqualified and shall vacate the office.

Each director is required to take oath of office obligating himself to administer diligently and honestly the affairs of the corporation, and not to violate or permit to be violated any of the provisions of the National Banking Act, and affirming that he is the owner of the requisite number of shares, standing in his name on the books, and that the same are not pledged or hypothecated in any way. Such oath must be transmitted to the Comptroller.

Vacancies may be filled for the unexpired term by the remaining directors.

Direct Loans.

The total loans to any one person, company, corporation, or firm, including the various members of such company or firm, shall not exceed 10 per cent of the capital and surplus of the bank, actually paid in and unimpaired

This limitation does not apply to

1 Discount of bills of exchange drawn in good faith against actually existing values. The latter includes drafts with bills of lading attached conveying or securing title to the goods, demand obligations secured by commodities covered by documents and in actual process of shipment, and bankers' acceptances described under Sec 13 of the Federal Reserve Act

2 The discount of commercial or business paper actually owned by the person, company, corporation or firm negotiating the same

3. Discount of notes secured by shipping documents, warehouse receipts, or such other documents conveying or securing title to readily marketable non-perishable staples, including live stock.

(a) When the actual market value of the property securing the obligation is not at any time less than 115 per cent of the face amount of the notes secured by such document;

(b) When such property is fully covered by insurance

4 Discount of notes amounting to 10 per cent of the bank's capital and surplus, secured by not less than a like face amount of bonds or notes of the United States, issued since April 24, 1917, or certificates of indebtedness of the United States

The accommodations granted any one borrower under

Section 3 above cannot exist for more than six months in any 12 months, and the aggregate of such accommodations for each borrower added to the direct loans to the same borrower which are subject to the 10 per cent limitation must not exceed 25 per cent. of bank's paid-in capital and surplus

Loans on Its Own Stock.

National banks cannot loan on or discount on the security of their own stock

Loans to Bank Examiners.

National banks are not permitted to make loans to or grant any gratuity to any national bank examiner.

Mortgage Loans.

Until the passage of the Federal Reserve Act, national banks were not permitted to loan on real estate security. Under the act, banks not in central reserve cities (New York, Chicago and St Louis) may make such loans under the following restrictions. The loan must be on improved and unencumbered *farm land*, situate within the Federal reserve district, or within 100 miles of the bank's place of business, irrespective of district lines

Mortgage loans may also be made on other than farm land, within 100 miles of the place of business irrespective of district lines, both classes being subject to the following restrictions

1. The loan must be a first mortgage.
2. The amount must not exceed 50 per cent. of the actual value of the property.
3. The total of such loans must not exceed one-third the time deposits of the bank, at the time of making the loan, or one-fourth the capital and surplus (Where the time deposits are greater than the capital and surplus the limit would be one-third the amount of time deposits)

4. The bank also may purchase or discount loans already made

5. Loans on farm lands shall not run longer than five years and on other property not more than one year. Loans so made may be renewed. Loans made under the above provisions should have proper evidence of compliance with the law as to title, security, appraisal, and time to run.

Dividends.

National banks are permitted to pay semi-annually, or quarterly, such dividends as the profits may warrant. Within 10 days of the declaration of such dividend the amount of the same and the net earnings in excess of such dividend must be certified to the Comptroller.

Dividends may not be declared

1. If the bank's surplus does not equal 20 per cent of the capital, unless one-tenth of the net profits are carried to surplus.

2. If the bank's reserve at the Federal reserve bank is below the legal requirement.

3. If losses have been sustained equal to or greater than the undivided profits then existing.

No dividend may be declared to an amount greater than its net profits then on hand, less the bad debts and losses. Bad debts are those on which interest is in arrears for six months or longer, unless well secured or in process of collection. Stock dividends are not lawful.

Real Estate.

National banks may hold real estate for the following purposes:

1. Such as shall be necessary for the transaction of their business.

2. Such as shall be mortgaged to them as security for debts previously contracted.

3 Such as shall be conveyed to them in satisfaction of debts previously contracted

4 Such as they shall purchase under judgments, decrees, mortgage foreclosure, or in settlement of debts to them

Such real estate taken for debt shall be sold within five years

Savings Deposits.

There has been considerable discussion as to the right of a national bank to operate a "savings" department as such, but it is held that these banks may legally receive deposits on which interest is paid and issue pass books similar to the custom of savings banks, and most of these banks operate such departments, by whatever name called.

Such deposits must be evidenced by pass book, certificate or other similar document, which must be presented at the bank whenever a deposit or withdrawal is made. And in order to become "time deposits," notice of withdrawal may be required as a requisite thereto. Usually the time of notice is 30 days, which is the minimum time under the Federal Reserve Act to class a deposit as "time," but as a rule such notice is not required in daily practice.

National Bank Notes.

Before beginning business, national banks were formerly required to deposit a certain amount of United States bonds with the United States Treasurer, for which they were allowed to take out national bank notes, but this is optional and not mandatory at the present time.

Upon the deposit of such bonds as are lawful as security for national bank notes, national banks may take out notes in the par amount. Upon the Panama Canal Bonds so lodged, there is a tax of one-quarter of 1 per cent half yearly upon the average amount of notes outstanding and so secured. Notes secured by bonds carrying a higher rate are taxed at one-half of 1 per cent semi-annually as above.

Bonds that are now legal for note issue purposes are

- 2 per cent bonds of 1930
- 2 per cent Panama Canal Bonds
- 4 per cent bonds of 1925

National bank notes must be signed by the president or vice president and cashier, and may be received at par for taxes, excises, public lands, and all other dues to the United States, except import duties, and for salaries, debts and demands to individuals and corporations, except interest on the public debt and redemption of the national currency. Notes that are retired from circulation are now macerated with proper certificate of destruction.

When a bank determines to issue circulation, it purchases bonds eligible for the purpose in the open market. These are sent to the Comptroller for deposit with the United States Treasurer. Only registered bonds are eligible, but coupon bonds may be converted into registered bonds.

The Comptroller's office attends to the details of printing the notes. The cost is about \$130 per plate, and the time depends upon the volume of work in the Bureau of Engraving and Printing, running from one to three months.

These notes are issued in denominations of \$5, \$10, \$20, \$50 and \$100. In determining the profit arising from circulation, several factors must be taken into consideration, such as the loaning rate for money, the market price of the bonds, the expenses of issue, and the sinking fund to retire the premium. I am indebted to Harvey Fisk & Sons, New York, specialists in government bonds, for illustrations showing the profit arising from such note issues, the proceeds of which are loaned in a 6 per cent market.

CIRCULATION TABLES

Value of Circulation Based on

\$100,000 United States 4 per cent bonds 1925 at 104 $\frac{3}{4}$, money at 6 per cent

\$100,000 4 per cent bonds would yield \$4,000 p a

100,000 Circulation loaned at 6 per cent 6,000 p a

\$10,000

Less tax on circulation, of 1 per cent 1,000

Less sinking fund to retire }
premium on bonds, to be }
set aside each year and }
improved, 6 per cent } 1,139

Less interest at 6 per cent on
5 per cent redemption fund 300

Less expenses 75 2,514

Net income with circulation \$ 7,486 p a

Net income without circulation

By loaning net cost of bonds, \$104 750, at 6 per cent 6,285 p a

Increased income \$1,201 p a

Date April 18, 1921

\$100,000 United States 2 per cent bonds 1930 at 100 $\frac{1}{4}$, money at 6 per cent

\$100,000 2 per cent bonds would yield \$2,000 p a

100,000 circulation loaned at 6 per cent 6,000 p a

\$8,000 p a

Less tax on circulation, $\frac{1}{2}$ of 1 per cent \$500

Less sinking fund to retire }
premium on bonds, to be }
set aside each year and }
improved, 6 per cent } 21

Less interest at 6 per cent on
5 per cent redemption fund 300

Less expenses 75 896

Net income with circulation \$7,104 p a

Net income without circulation

By loaning net cost of bonds, \$100 250, at 6 per cent 6,015 p a

Increased income . . . \$1,089 p a.

Date April 18, 1921

Redemption Fund.

National banks are required to keep on hand with the Treasurer of the United States an amount equal to 5 per cent of their circulation, as a redemption fund, through which the notes retired because of mutilation are credited and new notes issued in their stead are charged. As notes pass through the Treasury, or are sent in for redemption into new notes, they are destroyed and new notes issued, in order to keep the currency of the country clean and usable.

National bank notes that have been lost or stolen, or put into circulation without signatures or with forged signatures, are good.

Interest Rates.

The lawful rate of interest in national banks is the legal rate for the state in which they operate. Where no rate is fixed by the state the limit is 7 per cent. The taking of interest in advance (discount), together with exchange for instruments payable in another place, does not constitute usury.

The taking of more than the authorized interest forfeits the entire interest which the instrument carries or which has been agreed upon. Recovery may be had of twice the amount taken, by the one paying, or his legal representative, if action is begun within two years from the time of taking the same.

Certifying Checks

No check shall be certified unless the maker of the check has on deposit at the time an amount of money equal to the amount specified in the check. Any officer or clerk certifying against fictitious obligations, direct or collateral, in order to evade the provisions of the law, or who certifies before the amount shall have been

entered upon the books, shall be guilty of a misdemeanor. The penalty is \$5,000 fine or five years in prison, or both.

The penalty for embezzlement, abstraction, false entries, misapplication of funds on the part of any officer or clerk, or the issue of any instrument with intent to defraud, is imprisonment for not less than five nor more than ten years.

Reports and Examinations.

National banks must report to the Comptroller at least five times a year, within five days of receipt of notice. These reports are always dated a few days prior to the call, for obvious reasons. The reports must be verified by oath of the president or cashier, and attested by three directors. They must be published in a newspaper published in the county where the bank is located, and proof of publication must be submitted with the report. Special reports may be called for at any time.

Examinations are made by national bank examiners at least twice yearly without notice, and special examinations may be made under the direction of the Federal reserve bank at any time. Copies of these reports are lodged with the Comptroller and also with the Federal reserve bank.

Conversion of State Banks into National Banks.

State banks having unimpaired capital sufficient to entitle them to become national banks in the same locality may by vote of 51 per cent of the capital stock become national banks, subject to approval of the Comptroller.

State banks having branches and merging into the national banking system may retain and operate their branches. (This explains why some national banks in the large cities have branches, whereas as a general rule

national banks are not allowed to operate branches in this country.)

For the purpose of bringing or defending actions at law, national banks are deemed citizens of the state wherein they are located, and the circuit and district courts shall not have jurisdiction, except in such cases as they would have jurisdiction between individual citizens of the same state

At the expiration of the charter period, the corporate existence may be extended for a further period of 20 years

CHAPTER XIX

THE FEDERAL RESERVE BANK

Tested by the greatest war in history, involving the largest number of men ever engaged at one time in conflict, with a financial burden such as civilization has never borne, the Federal Reserve System has made good. Whether its splendid performance was due to the solidity of its basic principles, or its masterful handling, or our economic position as a neutral, is a matter of opinion, but it stands today classed as "the world's greatest banking system." And such it is; for it is a federation of American banking power, made supreme by the war. Had the burden of financing the world been upon us under the old régime, the financial collapse of our banking structure would undoubtedly have come to pass.

PREPARING FOR THE WAR

When the First Liberty Loan was offered, it was thought sufficient to announce the issue and the people would flock to buy, and banks thought themselves patriotic if they announced that they would handle subscriptions without charge, but the people did not flock to buy, and the banks not only handled subscriptions without charge, but eventually spent time without limit and money without stint to make the several war loans a success. The credit for financing the war belongs to the Federal reserve banks, which promptly took the situation in hand and rounded up an efficient and far-

reaching organization that achieved seemingly impossible results in putting the Liberty Loans "over the top"

Without doubt the master stroke was the conserving of the gold supply of the country. Even the country bankers will remember the edict that went forth to send all gold and gold certificates to the Federal reserve bank of the district, and to pay none out over the counter no matter what the occasion might be. This quickly mobilized our gold supply and put it under control. The yellow metal disappeared from circulation, and for years it was a comparative novelty for a bank teller to handle a "yellowback." With the gold supply of the country under control, and the supply of other countries coming to us in payment of war material, we built up the largest gold reserve in the history of the world.

Closely allied with the conservation of gold was the continuous functioning of the banks. There was no tightening of loans, no shortage of money, no stoppage of business, no doubt about the future value of the dollar. Our house was in order for a mighty struggle. The merchant or the manufacturer who had war contracts could get the credit he needed from his bank, and it in turn could pass the burden on to the Federal reserve bank. Currency there was in plenty for a vast movement in men and commodities. The government could borrow at a low rate and the people rallied to its support. From a nation of savings bank depositors we became a nation of bond buyers.

Causes for the Federal Reserve System.

The causes that led up to the inauguration of the Federal reserve banks may be summed up as follows:

- (a) A banking system composed of individual units, each jealous of its own welfare and working for itself alone.
- (b) The tendency to hoard cash whenever danger seemed to lurk in the financial outlook.

(c) Scattered reserves, in as many places as there were banks. These reserves had no mobilizing power, no directing head, no harmony of action and control.

(d) Rigidity of note issue, dependent upon the volume and price of Government bonds.

(e) The Treasury system of the United States, which as a collector of funds for Government purposes took money out of circulation.

(f) Lack of discount facilities.

(g) The custom of counting as reserve checks sent to reserve banks as soon as placed in the mails, of which there was a large quantity constantly in process of collection, commonly called "the float."

(h) Distrust of the banking system, and fear of its breaking down under the slightest strain.

Financial Unrest.

Prior to the advent of the Federal reserve banks there was a constant feeling of uncertainty. If we were not fearful of a panic, we were recovering from the effects of one. Distrust was in the air and suspicion was an easy thing to create. We were never sure that a black cloud did not hover near the financial horizon. Even so comparatively little an event as the San Francisco fire caused a world-wide disturbance. And what shall be said of the late war in contrast?

Prior to 1914 each of the twenty-five thousand banks was a single unit, working for itself, dependent in a large measure upon itself and jealous of itself. In the panic of 1907 we had forceful evidence of this in the hoarding that was well nigh universal. Not being certain of the soundness of our banking system, and doubtful of the adequacy of our money supply, each bank began to safeguard itself by accumulating money in its vaults, and by example its customers did the same thing. The only measure of safety to the average bank was its city correspondent, and this was in no better shape to create money than its country cousin. Fright took hold of the public, and money went to a premium because of the

general tendency to hoard. Runs on banks were not infrequent, and the closing of several large banks in New York added fuel to the flames

We had no such unrest during the war. Whether the people were too much concerned about the conflict to worry about their monetary affairs, or whether they had implicit confidence in the safety of the new system, will never be known. Certain it is that there was no panic, nor any semblance of one. The public seemed satisfied that the new system would work, and it did. It quickly allayed any spirit of distrust, and as soon as it began to function played a leading hand in the financial affairs of the world.

Scattered Reserves.

Banks operating under the National Banking Act are classified into central reserve banks, reserve banks and country banks. The central reserve banks are banks in the cities of New York, Chicago and St. Louis, the reserve banks are in such cities as Albany, Philadelphia, Baltimore, etc. (for present list of reserve cities see page 289), and the country banks are all others in the national banking system. The country banks were formerly required to carry reserves of 15 per cent, three-fifths of which could be in banks in reserve or central reserve cities. The reserve city banks were required to carry a reserve of 25 per cent, one-half of which could be in banks in central reserve cities; and the central reserve banks had to carry a reserve of 25 per cent, all in their vaults.

This worked out as follows. A bank in Syracuse, holding a reserve of \$300,000, could carry \$180,000 in Albany banks, the Albany banks could redeposit \$90,000 in New York, and the New York banks would have to carry \$22,500 of this in cash. The balance they could

loan in Wall Street, or elsewhere, at their pleasure. Therefore, if the Syracuse bank needed funds, it would draw on Albany, and Albany would draw on New York, thus placing the burden of carrying the load on New York. The New York banks had no alternative but to call loans, thus throwing the load upon Wall Street operations. We thus had a stock market panic, in addition to a bank or commercial panic, each time unrest took hold of the country. State banks followed essentially the same course.

There was no place where a bank could "cash in" its short time assets to meet unexpected demands, and the system of reserves and the rigidity of reserves worked mischief in every period of unsettled conditions.

Old System of Reserves.

Under our banking system as operated before the Federal reserve banks came into the field, each bank served its own territory, gathered deposits from its own clients, invested these deposits in bonds and loans, and carried its cash reserve with its city correspondent. It depended upon the latter to help out in case of need, but thus failing, it had to help itself. It carried two forms of reserves: (a) Cash on hand and in other banks, (b) bonds and short-time securities quickly salable in the market. The city banks carried large amounts in Wall Street loans payable on demand as aforesaid, and thus formed their secondary reserve, upon which they drew to meet the demands of their correspondents. As soon as danger menaced, the city banks would call their loans, thus producing a stock market panic, or sell their bond holdings, which accomplished the same results. There was no "national pawn shop," as it has been called in error, where a bank could cash in its discounted paper. The burden of financing the

country therefore fell upon the New York banks, and they in turn passed it on to Wall Street, the most sensitive place in the world

The chief difficulty lay in the rigid reserve requirements under national and state laws, whereby banks were required under penalty to carry the stipulated amount of reserves. These could not be used, even in panicky times, without breaking the law and incurring the displeasure of the supervising powers. The reserve was reserve in name only, and has well been likened to a condition where every man would be required to carry ten dollars in his pocket and never use it. No matter what the necessity might be, he cannot use the ten dollars, for in doing so he becomes a law breaker.

In contrast we now have a central reservoir of money where every bank may get what it needs—at a price—and a central pawn shop where it may pledge its valuables and get needed relief in time of trouble. Member banks in the Federal Reserve System must now carry their lawful reserve with the Federal reserve bank. They may draw it down below the legal limit upon certain penalties, and have the standing right to rediscount commercial paper that conforms to certain requirements. Each member bank therefore knows that as long as it holds eligible paper it can get funds upon demand, and its supply of money need never run short. There is thus created a confidence in itself and in the system that makes for safety, both to the banks and to the business public.

Inelastic Currency.

It will be seen from a study of Chapter XVIII that national banks were required to invest a portion of their capital in government bonds, which, upon lodging in the Treasury at Washington, would be returned in the

form of national bank notes. In fact, national bank notes are nothing but Government bonds divided into small denominations for convenience. Therefore, there could be no more currency than there were bonds, and the process of issue was slow and costly, as was also the process of retirement, when the demand ceased.

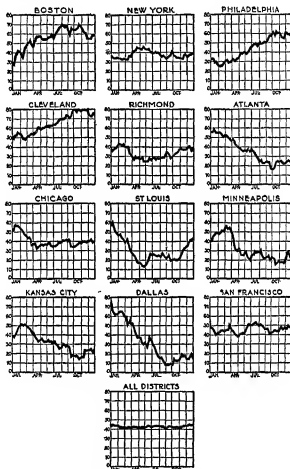
Before a bank could secure additional circulation it had to buy government bonds, and at times the supply was scarce, leading to a heavy premium for such securities. Moreover, it made a fictitious market for these bonds, far above their intrinsic worth.

On account of the seasonal demands for money to move the crops, the banks were kept in a state of anxiety for months during the late spring and early summer. In the winter and spring they were flooded with money from the harvest funds sent in by banks in the West and South, which were placed in call loans in Wall Street, and the demand for currency in summer and fall brought with it the problem of providing it without a stock market upheaval. The burden of investing the country's surplus funds thus fell upon New York, and the burden of distributing the funds when and as needed fell likewise upon her.

Maintaining Credit Elasticity.

The way in which credit elasticity was maintained and credit was sent where it was most needed is graphically illustrated by the following diagram, which shows for the year 1920 the reserve percentages of each of the reserve banks before giving accommodation to other reserve banks or receiving accommodation from them. While the reserves of all these banks were actually kept at or above the legal minimum of 40 per cent on notes and 35 per cent on deposits by means of rediscounting between Federal reserve banks where necessary, the lines in the diagram show what the reserves would have been had each reserve bank operated purely as an independent institution, relying only upon its own reserves. The diagram illustrates

particularly clearly the heavy seasonal assistance which reserve banks in the agricultural sections require, and shows the Federal



Reserve percentages of Federal Reserve Banks each week in 1920 as they would have appeared if no borrowing had taken place between Federal reserve banks

Reserve Bank of New York at times as a lender and at times as a borrower

But in the reserve percentage of the entire Federal Reserve System

shown in the block at the bottom of the diagram there were no such wide fluctuations as occurred in the percentages of the individual banks. While reserves in individual banks fell as low as 9 per cent and rose as high as 81 per cent, the reserves of the system as a whole fluctuated between the narrow limits of 45.8 per cent and 41.4 per cent. There could be no better evidence of the unity of the system brought about by the rediscounting operations between the 12 reserve banks which are carried on when needed under the direction of the Federal Reserve Board. These operations were effected instantly over private telegraph lines and settled for daily through the Gold Settlement Fund. Thereby, the 12 reserve banks, for all purposes requiring the extension or transfer of credit between various sections of the country, became in effect a single reservoir of credit. And through these operations it was possible to maintain a degree of equilibrium in credit heretofore unknown in the United States.¹

Under a system of rigid and scattered reserves, and with an inelastic currency system to meet the unequal demands that fell upon the banks, our banking structure broke down at critical times, when stability and safety demanded that it continue to function. The situation would be the same if a bridge were built for the ordinary needs of travel only, but when a holiday or a homeward-bound rush placed a heavier load upon it, it collapsed under the added strain.

History of Inelastic Currency.

In its *Monthly Review of Trade Conditions*, as of May 1, 1921, the Federal Reserve Bank of New York reviews the history of our inelastic currency and makes interesting comment as follows:

"For the half century prior to 1914 the United States suffered from an inelastic currency. At times there was too much currency and at other times too little. When there was too much currency for the needs of business there was no way of reducing it, interest rates fell very low and speculation was encouraged. On the other hand, almost every autumn, when large amounts of currency were needed

¹From the Report of the New York Federal Reserve Bank, for 1920.

for the harvests, there was difficulty in getting together enough currency, the same was true in the cities at the Christmas shopping seasons. This scarcity of currency at such seasons generally brought about very high interest rates, and when times of real apprehension occurred, as in the autumn of 1907, every bank and many individuals began to hoard currency, which instead of helping the situation only accentuated its difficulties.

"After the panic of 1907 Congress determined to put an end to the inelasticity of our currency and to provide a currency which would expand and contract in accordance with the needs of industry, commerce and agriculture. Without disturbing the existing forms of currency, namely gold, gold certificates, silver, silver certificates, legal-tender notes and national bank notes, and without disturbing the rights, powers and functions of existing national banks, state banks and trust companies, Congress created 12 Federal reserve banks to hold the banking reserves of the country and to issue an elastic currency, responsive to the needs of the country. The gold, which is the basis of bank credit and banking power, was transferred from the thousands of banks and trust companies and placed in these 12 great reservoirs to serve as the basis for such additional credit as the country might need, whether in the form of additional deposits or additional currency. The amount of gold now held by the Federal reserve banks is \$2,300,000,000. When this gold was scattered about in the hands of the people and in the twenty-five thousand banks of the country there was no common reservoir to which they could turn, and each bank feared lest its supply should run out. But now that the reservoir is formed and is available to all member banks in accordance with their needs, no such fear exists. For any member bank, by discounting with its Federal reserve bank the paper of its industrial, commercial or agricultural customers, or paper secured by Government war obligations, may get credit from the Federal reserve bank either in the form of a deposit with the bank or in the form of Federal reserve notes.

"We pay our bills in two ways, either by drawing checks against our deposit account in our bank, or by means of hand-to-hand currency. Experience shows that for every five or six dollars of bank deposits a dollar of hand-to-hand currency is necessary in order that we may pay for things in our accustomed manner. During the war bank deposits increased very greatly. This increase in bank deposits would not have occurred unless it had been possible to increase hand-to-hand currency proportionately. Consequently the member banks

had to come to the Federal reserve banks and discount with them a very large volume of their paper in order to secure the hand-to-hand currency, in the form of Federal reserve notes, which their customers required. The war, the greatest emergency the world has known, tested the note-issuing powers of the Federal reserve banks and found them thoroughly responsive to the *increasing* needs of the country.

"Each Federal reserve bank keeps on hand at all times an immense supply of unissued Federal reserve notes, aggregating for the entire Federal reserve system over a billion dollars. These Federal reserve notes are called into circulation as the member banks need them. They get notes by drawing checks on their deposit accounts and cashing them in reserve notes or other currency, just as an individual would do at his own bank. Each member bank carries on hand such currency as it finds the demands of its customers require. It knows that at any time it can get additional currency promptly from its reserve bank, consequently when it accumulates more currency than it needs it sends the excess in to the reserve bank. The reserve bank pays shipping costs on currency both to and from out-of-town member banks. This greatly facilitates the prompt reduction of the volume of currency as soon as it is not needed and economizes the use of currency, since with the element of cost removed member banks carry only what is absolutely required. When notes are returned to the reserve bank they are automatically withdrawn from circulation until called for again by some member bank.

"The volume of notes handled by the reserve banks is very great. In the New York bank about 300 clerks are constantly sorting, counting, and shipping currency. On the average about 2,500,000 notes are handled by the money counters every day."

Government Money.

There was also the constant menace of the Government's financial operations. The receipts from taxes, import duties, excise moneys, etc., were deposited in the United States treasuries, there to be locked up until some pressing need developed, when they were released and deposited in the banks of the Government's choosing. When the need became acute, the Secretary of the Treasury would release part of these funds, thus relieving the situation somewhat, but by a method that

smacked of favoritism and politics rather than of sound finance

No Discount System.

There was no rediscount system, as such, in this country. There was no place where a solvent bank could take its perfectly good assets and turn them into money. It could sell its bonds and perhaps take a loss, which is against human nature, it could call loans and thus, perhaps, put the load upon some other bank, but it could not, as a right, demand that its short-time loans be turned into bank notes, as is now the case under the Federal Reserve System.

In its very comprehensive review of the National Bank Act and the Federal Reserve System,¹ the National City Bank outlines the causes for the Federal Reserve System, by showing the weaknesses of the old régime as found by the inquiry conducted by the National Monetary Commission, as follows:²

Reserves

1—There was no provision for concentrating the cash reserves of the banks and for their mobilization and use in times of need,

2—Inadequate federal and state laws restricted the use of bank reserves, thus decreasing lending power,

3—The banks lacked adequate means for replenishing their reserves or increasing their loaning power under unusual demands.

Currency

Bank note currency—the only form of currency which might be expected to respond by expansion and contraction to unusual needs—was deprived of elasticity because its volume largely depended upon the amount and price of United States bonds.

¹ "National Banking Under the Federal Reserve System," National City Bank, New York.

² The compilation known as the "Reports of the National Monetary Commission" covers banking and finance in all parts of the world, and is the most comprehensive and readable collection of banking information extant. It gives a most interesting review and the results of investigation at first hand of the banking systems of the principal countries of the world.

Co-operation

- 1—Banks lacked the means to insure such effective co-operation as was necessary to protect their own and the public's interests in times of stress. There was no co-operation of any kind among banks outside of clearing house cities,
- 2—The banks had no effective agency covering the entire country affording necessary facilities for making domestic exchanges

Commercial paper

- 1—Lack of commercial paper of an established standard issued for agricultural, industrial and commercial purposes, and available for investment by banks, had led to an unhealthy congestion of loanable funds in great centers, thus hindering production throughout the country on the whole,
- 2—There was no open market for the discount of such paper,
- 3—There was a disparity in discount rates throughout the country generally, and there was in existence no agency the influence of which could secure uniformity, steadiness and reasonableness in rates of discount

No banking facilities for emergency cases

We had no effective agency that could surely provide adequate banking facilities for different regions, promptly and on reasonable terms, to meet the ordinary or unusual demand for credit or currency necessary for moving crops or for other legitimate purposes

Lack of uniformity

There was no power to enforce uniform standards throughout the country with regard to capital, reserves, examinations and the character and publicity of reports of all banks in the different sections of the country

Foreign banking

There were no American banking institutions maintaining branches in foreign countries, and the organization of such foreign branches was necessary for the proper development of our foreign trade

Loans on real estate

The inability of national banks to legally make loans upon real estate restricted their power to serve farmers and other borrowers in rural communities.

The Federal reserve system corrects these evils

A By uniting the banks into a harmonious system with a single-headed control

B The hoarding of cash is unnecessary, inasmuch as cash can always be had in return for eligible paper

C The reserves of the banks are now mobilized under the control of the Federal reserve banks, and may be used where and when necessary They go from the place of surplus to the place of dearth

D Federal reserve notes expand and contract in relation to the volume of business, as represented by the paper offered for discount and the demands of commerce and industry

E Government money is now deposited with the Federal reserve banks, and is always available for the use of business interests

F Any member bank may now discount its paper holdings freely, as its needs require, as a right, and not as a favor from a correspondent

G Checks are collected in the shortest possible time

H Distrust has given way to confidence, the bulwark of all financial systems

I Interest rates are now regulated and controlled and are in a great measure uniform They are under control and move up or down as the Federal Board decides is necessary for proper control of business

J Loans may now be made on real estate security as treated on page 263

Salient Features of the Federal Reserve Bank.

The Federal Reserve System unites the banking power of the United States into a harmonious whole by requiring all national banks to become members, and permitting other banks and trust companies to unite upon the same general terms as national banks enjoy membership It is a *bank of banks*, and individuals cannot deal with it except in the matter of Liberty Bonds and Government certificates of indebtedness, except through the medium of a bank

National banks must carry their entire reserve with the Federal reserve bank of the district, thereby uniting the reserves of these banks into one fund. State banks

and trust companies, however, in some jurisdictions are permitted by the state laws to carry only part of their reserves with the Federal reserve banks

THE REQUIRED RESERVES ARE

	DEMAND DEPOSITS	TIME DEPOSITS
Country banks	7 per cent	3 per cent
Reserve city banks	10 per cent	3 per cent
Central reserve banks	13 per cent	3 per cent

Demand deposits are those payable within 30 days; time deposits are those payable after 30 days, savings accounts and certificates of deposit, which are subject to not less than 30 days' notice of withdrawal, and Postal Savings deposits

The strength of these reserves lies in the fact not only that they are under one control, but also that funds may be shifted from one section of the country to another as business needs require, by one reserve bank lending another of its surplus

Banks May Continue to Function.

There come times in the experience of all banks when they are "loaned up"—meaning that their customers have made such heavy demands upon them that they have no available funds for loaning purposes and must cease the loan function. To overcome this, a bank may dispose of part of its present holdings to the Federal reserve bank, and resume its loaning policy to its own customers. In short, it replaces one loan with another, assuming a contingent liability only in so doing. It may thus continue to function as long as it follows the prescribed line of conduct as reflected in short, liquid loans for business purposes

A Bank for Business Needs.

It was the intention to make the Federal reserve banks a system for business men and their needs, and not a

stimulator of Wall Street operations, therefore, no paper that arises from stock and bond transactions or loans for fixed purposes, such as investments, no matter how well secured, may find entry into the Federal reserve bank. Let us illustrate. Here is a note secured by United States Steel, preferred. It cannot be discounted at the Federal reserve bank. Neither can a note taken by a bank as an accommodation loan to one of its customers, nor a note given by one to another as a mere loan of money. The note must arise out of a transfer of goods, and a note given by a plumber for supplies, a builder for lumber, a merchant for stock, may be rediscounted.

Paper to be eligible for rediscount must have the following general qualifications

- 1 It must be of short duration, not over 90 days, except that a limited amount of agricultural paper based upon live stock may have six months' maturity

- 2 It must arise out of a commercial transaction

- 3 It must bear the indorsement of a member bank and be issued for the purpose of trading in or carrying United States obligations

- 4 It must be based upon goods in storage or in transit represented by proper documents

Therefore the banks may at all times turn their assets into reserve or money, as desired, if they can furnish eligible paper.

When such paper is offered for discount, the Federal reserve bank may issue Federal reserve notes, if it has a gold reserve of 40 per cent. of the amount of notes issued, that is to say, if a bank requires currency, and it lodges with the Federal reserve bank \$1,000 of eligible paper, it may receive in return \$1,000 in Federal reserve notes, provided the Federal reserve bank holds \$400 in gold against the notes. In other words, back of every dollar of Federal reserve notes there is \$1 of eligible

paper and 40 cents in gold. This process has given and will give the country an elastic currency system that expands and contracts as the business needs require.

Check Collections

As has previously been stated, the Federal reserve banks now collect practically all checks at par, and in so doing they have made the bank check worth its face value everywhere.

Prior to the advent of the Federal System, banks were inclined to send checks by such routes as proved the least costly, irrespective of the time consumed in making the collection. Checks were collected by roundabout methods, bank to bank, in the endeavor to escape the exchange charge, so that there was a vast amount in the mails all the time, in process of collection, called the "float." These funds were regarded as equivalent to reserve as soon as placed in the mails, an obvious error.

The Federal reserve banks have reduced this float to a minimum by sending checks by the most direct routes, and withholding credit until the checks can actually be presented for payment. By using the Federal reserve bank nearest the place of payment, a bank may now collect its checks with a greater expedition than has ever obtained in check collections heretofore.

Banks are now permitted to ship currency and to receive the same from the Federal reserve banks at the latter's expense, thus placing the cost of such shipments upon the Federal banks and not upon the members.

The private wire system of the Federal reserve banks greatly increases the facility for handling checks, and transfers of funds, confirmation and advices of non-payment are therefore quickly obtainable through the efficiency of the telegraph.

It is of paramount importance to the business interests

of the country that check collections be promptly and cheaply made, inasmuch as it gives the depositor use of the funds at the earliest moment and advises him of the non-payment of checks promptly, and such facilities are furnished by the Federal reserve banks to the limit of efficiency

The settlement of debts between various sections of the country through the gold settlement fund (see page 108) also makes for a highly useful purpose, in that the expense of shipping money is avoided. Through this fund, large payments are made by wire, and settlements effected at no cost in transportation and without danger of loss.

Administration.

The Federal Reserve System is under the control of the Federal Reserve Board of seven members. Five are appointed by the President and confirmed by the Senate, the Comptroller of the Currency and the Secretary of the Treasury being members *ex officio*. The compensation is \$12,000, and the Comptroller receives a salary of \$7,000 as member of the Board. One of the members is termed "Governor of the Federal Reserve Board" and another "Vice-Governor". The expenses of the Board are paid by the Federal reserve banks. The head office is in Washington.

The country is divided into 12 Federal reserve districts, with a Federal reserve bank in each, some of them having one or more branches. Such banks are now located in New York, Boston, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas and San Francisco. New York has a branch at Buffalo, Richmond has one at Baltimore, Cleveland has branches at Cincinnati and Pittsburgh, Kansas City at Omaha and Denver, and San Francisco at Portland, Spokane, Seattle and Salt Lake City.

All national banks are required to join the system, and other banks and trust companies are authorized to join. The two latter must have the same capital as would be required for a national bank in the same location.

Capital.

Banks joining the Federal Reserve System are required to invest 6 per cent of their capital and surplus in the capital of the Federal banks, one half of which has been paid in and the balance is subject to call. (This latter half will probably never be called for.) Banks increasing their capital must increase their Federal reserve stock holdings, and in reducing the same they may surrender their surplus stock. Stockholding banks are liable to the extent of their subscriptions to the stock of the Federal bank, in addition to the amount subscribed, at par. In other words, they are doubly liable to the extent of their subscriptions to the stock.

The various Federal reserve banks were required to have a capital of at least \$4,000,000 subscribed before beginning business. This capital increases as banks join the system or increase their capital or surplus, and decreases as they reduce their capital or surplus, or withdraw from the system. Reserve and central reserve cities¹

¹ Central reserve cities are New York, Chicago and St. Louis. Reserve cities: Boston, Albany, Brooklyn and Bronx, Buffalo, Philadelphia, Pittsburgh, Baltimore, Washington, Richmond, Charleston, Atlanta, Savannah (was a reserve city, but there were no national banks there January 1, 1921), Jacksonville, Birmingham, New Orleans, Dallas, El Paso, Fort Worth, Galveston, Houston, San Antonio, Waco, Little Rock, Louisville, Chattanooga, Memphis, Nashville, Cincinnati, Cleveland, Columbus, Toledo, Indianapolis, Peoria, Detroit, Grand Rapids, Milwaukee, Minneapolis, St. Paul, Cedar Rapids, Des Moines, Dubuque, Sioux City, Kansas City, Mo., St. Joseph, Lincoln, Omaha, Kansas City, Kas., Topeka, Wichita, Denver, Pueblo, Muskogee, Oklahoma City, Tulsa, Seattle, Spokane, Tacoma, Portland, Los Angeles, Oakland, San Francisco, Ogden, Salt Lake City.

remain as under the National Bank Act except as to reserves.

The Federal reserve banks are chartered for 20 years. The usual powers as to right to make contracts, appoint officers, sue and be sued, adopt by-laws, etc., are granted.

Board of Directors

The board of directors of the Federal reserve bank consists of nine members, divided into Classes A, B and C. Class A represents the member banks, Class B the industrial and commercial interests; and Class C is appointed by the Federal Reserve Board. The manner of electing directors of Classes A and B is as follows:

"The Federal Reserve Board shall classify the member banks of the district into three general groups or divisions, designating each group by number. Each group shall consist as nearly as may be of banks of similar capitalization. Each member bank shall be permitted to nominate to the chairman of the board of directors of the Federal reserve bank of the district one candidate for director of Class A and one candidate for director of Class B. The candidate so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each member bank. Each member bank by a resolution of the board or by an amendment to its by-laws shall authorize its president, cashier, or some other officer to cast the vote of the member bank in the elections of Class A and Class B directors.

"Within fifteen days after receipt of the list of candidates the duly authorized officer of a member bank shall certify to the chairman his first, second, and other choices for director of Class A and Class B, respectively, upon a preferential ballot upon a form furnished by the chairman of the board of directors of the Federal reserve bank of the district. Each such officer shall make a cross opposite the name of the first, second, and other choices for a director of Class A and for a director of Class B, but shall not vote more than one choice for any one candidate. No officer or director of a member bank shall be eligible to serve as a Class A director unless nominated and elected by banks which are members of the same group as the member bank of which he is an officer or director.

"Any person who is an officer or director of more than one member bank shall not be eligible for nomination as a class A director except by banks in the same group as the bank having the largest aggregate resources of any of those of which such person is an officer or director

"Any candidate having a majority of all votes cast in the column of first choice shall be declared elected. If no candidate have a majority of all the votes in the first column, then there shall be added together the votes cast by the electors for such candidates in the second column and the votes cast for the several members in the first column.

"If any candidate then have a majority of the electors voting, by adding together the first and second choices, he shall be declared elected. If no candidate have a majority of electors voting when the first and second choices shall have been added, then the votes cast in the third column for other choices shall be added together in like manner, and the candidate then having the highest number of votes shall be declared elected. An immediate report of election shall be declared."

Class C directors shall be appointed by the Federal Reserve Board. They shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said board as "chairman of the board of directors of the Federal reserve bank," and as "Federal Reserve Agent." He shall be a person of tested banking experience, and in addition to his duties as chairman of the board of directors of the Federal reserve bank, he shall be required to maintain, under regulations to be established by the Federal Reserve Board, a local office of said Board on the premises of the Federal reserve bank. He shall make regular reports to the Federal Reserve Board and shall act as its official representative for the performance of the functions conferred upon it by the act. He shall receive an annual compensation to be fixed by the Federal Reserve Board, and paid monthly by the Federal reserve bank to which he is designated.

One of the directors of Class C shall be appointed by the Federal Reserve Board as "deputy chairman" to

exercise the powers of the chairman of the board when necessary. In case of the absence of the chairman and deputy chairman, the third Class C director shall preside at meetings of the board

There is also provision for assistants to the Federal Reserve Agent to be appointed by himself, subject to approval of the Federal Reserve Board

There is thus a control from above, by the Federal Reserve Board, and control and representation from below, representing the banking and commercial interests of the territory covered by the Federal reserve banks.

Senators and representatives in Congress cannot be members of the Federal Reserve Board, or directors or officers of any Federal reserve bank

Directors in Class B cannot be officers, directors or employees of any bank; directors in Class C cannot be officers, directors, employees or stockholders in any bank The term of directors is three years.

Division of Earnings.

After providing for the necessary expenses of operation, the stockholders of Federal reserve banks are entitled to dividends of 6 per cent on the paid-in stock After this distribution, the net earnings are to be paid into surplus until the same equals 100 per cent. of the subscribed capital stock. Thereafter 10 per cent of the earnings go to surplus. All earnings over these apportionments are paid to the Government as a franchise tax

Federal Reserve Notes.

Federal reserve notes are issued by the various Federal reserve banks through the Federal Reserve Agent They are obligations of the United States, and are receivable by member banks and Federal reserve banks for all taxes, customs, and public dues. They are

redeemable in gold at the Treasury of the United States in Washington or in gold at any Federal reserve bank

They are issued upon tender of eligible paper as defined by the Federal Reserve Board and treated subsequently

Reserves in gold must be maintained by Federal reserve banks as follows

Against deposits	35 per cent
Against notes	40 per cent

Notes received by one Federal reserve bank and issued by another (each bank has a distinctive number, New York being No. 2) must be promptly returned to the bank of issue for credit and redemption. No Federal reserve bank can pay out the notes of another under a tax of 10 per cent.

Notes presented through the U S Treasury are redeemed through a redemption fund similar to the 5 per cent redemption fund for national banks, not less than 5 per cent of the amount outstanding, which amount may be included in the 40 per cent gold reserve above noted

The printing of the notes and their delivery are made part of the functions of the Comptroller's office under direction of the Secretary of the Treasury. The security for the notes, commercial paper, is held by the Federal Reserve Agent

Federal Reserve Bank Notes.

Federal reserve banks have the right to issue Federal reserve *bank* notes upon the same conditions and under the same procedure as national bank notes are issued, except they are not limited to the amount of the capital of the Federal reserve banks.

The question often arises in the mind of the student as to the distinction between Federal reserve notes and Federal reserve *bank* notes. It is this. Federal reserve

bank notes are precisely the same as national bank notes, except that they are issued by Federal reserve banks instead of national banks. They are, like national bank notes, secured by United States Bonds, while the Federal reserve notes are secured by gold and commercial paper, as before stated. Eventually the issue of notes based upon Government bonds will be taken over by the Federal reserve banks, and in due course, national bank notes will be taken out of circulation.

The Federal Reserve Board has the following rights:

To exercise general supervision over Federal reserve banks, require bonds, make regulations for safeguarding collateral, bonds, reserve notes, money, etc.

To grant to national banks, when not in contravention of state or local laws, the right to act as executor, trustee, administrator, receiver, transfer agent for stocks and bonds, guardian, assignee, receiver, etc., the same as a trust company in the same jurisdiction enjoys. By this rule, many national banks have opened "trust departments" which are operated in the same manner as the trust company operates its trust functions.

To permit rediscounts between Federal reserve banks and suspend reserve requirements under penalties specified for the impairment of reserves.

To regulate the issue of notes, name reserve cities, suspend officers of Federal reserve banks and make such regulations as it may deem expedient for the conduct of the banks under its jurisdiction.

Statements of all Federal reserve banks as units and a consolidated statement of the 12 banks are published weekly.

Eligible Paper.

We have seen that one of the primary functions of the Federal reserve banks is the rediscount of commercial

paper. The law is general and not specific in this matter, leaving it to the Federal Reserve Board to determine what paper may be accepted for rediscount. The Board has from time to time issued rules and regulations governing eligible paper, a brief summary of which follows.

Paper that is eligible for rediscount in the Federal reserve banks consists of three general classes

(a) Notes, drafts, bills of exchange, trade acceptances, and agricultural paper running not over six months.

(b) Bankers' acceptances

(c) Bills of exchange, trade acceptances, and bankers' acceptances purchased in the open market

(To make paper eligible, it must arise out of a business transaction and not be for the purpose of carrying stocks and bonds or for permanent investment purposes)

Definitions.

The Federal Reserve Board has defined certain instruments as follows

A *promissory note* is an unconditional promise in writing, signed by the maker, to pay in the United States, at a fixed or determinable future time, a sum certain in dollars, to order or to bearer

A *draft* or *bill of exchange* is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay in the United States, at a fixed or determinable future time, a sum certain in dollars to the order of a specified person

A *trade acceptance* is a draft or bill of exchange drawn by the seller on the buyer of goods sold, and accepted by the buyer

Agricultural paper consists of notes, drafts, bills of exchange or trade acceptances, drawn or issued for

agricultural purposes or based on live stock, that is, the proceeds of the above instruments have been used or are to be used for agricultural purposes, including the breeding, raising, fattening or marketing of live stock. Such paper must have a maturity at time of discount of not more than six months, exclusive of days of grace

Federal Reserve Rediscounts.

Federal reserve banks may rediscount for any of their members notes, drafts or bills of exchange as follows

1. Instruments that have a maturity of not more than 90 days at the time of rediscount, exclusive of days of grace, but if drawn for agricultural purposes as above set forth, the maturity may be six months.

2. Instruments that arise out of actual commercial transactions, that is, notes, drafts and bills of exchange that have been issued or drawn for agricultural, industrial or commercial purposes, or the proceeds of which have been used or are to be used for such purposes

- 3 *Instruments arising out of carrying or trading in stocks and bonds or other investment securities, except Government securities, are not eligible for rediscount.*

- 4 The aggregate of notes, drafts, and bills bearing the indorsement or signature of any one borrower, whether person, firm, company, or corporation, rediscounted for one member bank, shall at no time exceed 10 per cent of the unimpaired capital and surplus of the bank, but this limitation does not apply to bills of exchange drawn in good faith against actually existing values

- 5 Such discounted paper must be indorsed by the member bank. Federal reserve banks may make advances to their members upon promissory notes for a period of not over 15 days, provided such notes are secured by eligible paper, or by deposit of United States

bonds or certificates of indebtedness or bonds of the War Finance Corporation. In defining eligible paper, the Board lays down the basic rules as follows:

It must be a note, draft or bill of exchange, issued or drawn, or the proceeds of which have been used or are to be used, in the first instance, in producing, purchasing, carrying or marketing goods in one or more of the steps of the process of production, manufacture or distribution, or for the purpose of carrying or trading in bonds or notes of the United States.

It must *not* be a note, draft or bill the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings or machinery, or for any other capital purpose. It must *not* be a note, draft or bill the proceeds of which have been used or are to be used for investments of a purely speculative character, or for the purpose of lending to some other borrower. It may be secured by a pledge of goods or collateral of any nature, including eligible paper, provided the instrument itself is eligible otherwise.

State Banks as Members

State banks and trust companies that join the Federal Reserve System are required to have the same capital as required for national banks in the same place, and to observe the same limitation as to loans, purchase of or loans upon their own stock, payment of dividends and impairment of capital as obtains in national banks, and to observe the rules of the Federal Reserve Board, and such other penalties and restrictions as are required of national banks. Reports to the Federal reserve bank as to condition and dividends are also required. State banks and trust companies are permitted to withdraw upon six months' written notice. National banks cannot withdraw except as they become state banks.

Advisory Council.

There is an advisory council composed of as many members as there are Federal reserve districts. These members are selected by the boards of directors of the Federal reserve banks. Meetings are held in Washington at least four times a year.

Open Market Operations

Federal reserve banks may deal in coin and bullion at home or abroad, buy and sell at home or abroad notes of the United States, bills, notes, revenue bonds, and warrants with a maturity of not over six months, issued in anticipation of taxes or receipt of revenues of any state, county, or municipality, including drainage and reclamation districts, etc. They may also buy and sell bills of exchange arising out of commercial transactions.

Discount Rates.

Each Federal reserve bank shall fix the discount rates for various classes of paper, and has the power to establish accounts in foreign countries, appoint correspondents and establish agencies for the purpose of buying, selling and collecting bills of exchange and to buy and sell abroad such bills as it is allowed to discount.

The moneys of the Government are deposited in the Federal reserve banks, which act as fiscal agents of the United States.

Retirement of National Bank Circulation.

It is the intent of the Federal Reserve Act to ultimately retire the national bank notes and substitute Federal reserve bank notes. Banks may file application to retire their notes and to sell the bonds held as security for the same. The Federal reserve banks are

then required to purchase the bonds, for which they may issue their Federal reserve bank notes.

Miscellaneous Provisions of the Act.

The reserve account kept by member banks may be checked against as in ordinary checking accounts bank with bank

The 5 per cent redemption fund is no longer counted as reserve in national banks

Examinations of member banks are required twice each year by the Comptroller, except in the case of state banks and trust companies, where the examination of the state authorities may be accepted. Examinations may also be made by examiners under the direction of the Federal reserve bank of the district

Bankers' Acceptances.

A *bankers' acceptance* is a draft or bill of exchange, whether payable in the United States or abroad, in dollars or other form of money, of which the acceptor is a bank or trust company, or a firm, person, company or corporation engaged generally in the business of granting bankers' acceptance credits.

Federal reserve banks may rediscount such paper having a maturity of not over three months, excluding days of grace, which has been drawn under a credit opened for the purpose of conducting or settling accounts resulting from transactions involving

- 1 The shipment of goods between the United States and any foreign country, or between the United States or any of its dependencies, or between foreign countries

- 2 The shipment of goods within the United States, provided shipping documents securing title are attached at the time of acceptance

3. The storage of readily marketable staples, provided

the bill is secured at the time of acceptance by warehouse receipt or other such document conveying security title

Open Market Operations.

Section 14 of the Federal Reserve Act provides that Federal reserve banks under rules and regulations to be prescribed by the Federal Reserve Board may purchase and sell in the open market, at home or abroad, from or to domestic or foreign banks, firms, corporations, or individuals, bankers' acceptances and bills of exchange of the kinds and maturities made eligible by the act for rediscount, with or without the indorsement of a member bank.

The Federal Reserve Board, exercising its statutory right to regulate the purchase of bills of exchange and acceptances, has determined that a bill of exchange or acceptance, to be eligible for purchase by Federal reserve banks under this provision of Section 14, must have been accepted by the drawee prior to such purchase, unless it is either accompanied or secured by shipping documents or by warehouse, terminal, or other similar receipt conveying security title, or bears a satisfactory banking indorsement, and must conform to the relative requirements of Regulation A, except that—

(a) A bankers' acceptance growing out of a transaction involving the importation or exportation of goods may be purchased if it has a maturity not in excess of six months, exclusive of days of grace, provided that it conforms in other respects to the relative requirements of the Federal Reserve Board, and

(b) A bankers' acceptance growing out of a transaction involving the storage within the United States of goods actually under contract for sale and not yet delivered or paid for may be purchased, provided that the acceptor is secured by the pledge of such goods, and provided

further that the acceptance conforms in other respects to the relative requirements of Regulation A

A bill of exchange, unless indorsed by a member bank, is not eligible for purchase until a satisfactory statement has been furnished of the financial condition of one or more of the parties thereto

A bankers' acceptance, unless accepted or indorsed by a member bank, is not eligible for purchase until the acceptor has furnished a satisfactory statement of its financial condition in form to be approved by a Federal reserve bank and has agreed in writing with a Federal reserve bank to inform it upon request concerning the transaction underlying the acceptance

Acceptances by Member Banks.

Before the advent of the Federal Reserve Act, national banks were not permitted to make acceptances. They may now do so upon the following conditions

- 1 The paper must arise from an import or export of goods

- 2 Paper arising from a domestic transaction must have accompanying it shipping documents conveying or securing title, which documents must be attached at the time of the acceptance

- 3 The storage of readily marketable staples (such as articles having a steady and constant demand, the price easily ascertainable, and the article itself easy to realize upon by sale), provided the bill is secured at the time of acceptance by warehouse receipt, securing or conveying title

The limit of such acceptances for any one person, firm, company or corporation is 10 per cent of the surplus and capital of the bank. This limit does not apply where the bank so accepting is secured by documents or other actual security growing out of the transaction.

The limit of such acceptances for any one bank at any one time is one-half the bank's unimpaired capital and surplus, but with the consent of the Federal Reserve Board, the bank may make acceptances up to 100 per cent of its capital and surplus

Acceptances growing out of domestic transactions must not exceed 50 per cent of the capital and surplus

Check Collections Under the Federal Reserve Act

Under the provisions of Section 16 of the Federal Reserve Act, the various Federal reserve banks are authorized to collect checks, acting in the capacity of a nation-wide clearing house for the members. Under Section 13 as amended June 21, 1917, Federal reserve banks are also authorized to receive from any non-member, solely for the purposes of exchange or collection, deposits of lawful money, national bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, provided the non-member maintains with the Federal reserve bank a balance sufficient to offset the items in transit for its account

Under these provisions of the law, the Federal reserve banks are now collecting checks on all parts of the country in large volume, both for member and non-member banks. The general terms are as follows

1. Federal reserve banks now receive at par from member and non-member clearing banks of their districts checks drawn on all member and non-member clearing banks and on all other non-member banks that agree to remit at par through the Federal reserve bank of their district

2. Each Federal reserve bank will receive from other Federal reserve banks and from member and non-member clearing banks, wherever they may be, for the

credit of their account with the Federal reserve bank of their district, checks drawn upon all member and non-member clearing banks of its district and upon all other non-member banks of the district whose checks can be collected at par by the Federal reserve banks (Under this rule a bank may send its items to the Federal reserve bank of the district nearest the point of collection. Thus, the Irving National Bank, having a check on Kansas, could send it to the Federal reserve bank of Kansas City)

3. Immediate credit is given at par for the items so received, subject to final payment, but these credits do not become available as reserve, nor can they be checked against until the time specified in the time schedules sent out by the Federal reserve banks, which divide the country into one, two, four and eight-day points

4 Checks received by the Federal reserve bank on member and non-member clearing banks are sent direct to such banks, but are not charged to their accounts until sufficient time has elapsed within which to receive advice of payment, according to the aforesaid time schedules

Banks are allowed to check against their balance with the Federal bank, thus reducing the balance below the required minimum, but no bank can make loans or declare dividends until the required balance is restored to its minimum. There is an interest penalty provided for withdrawing the balance below the legal minimum.

These time schedules are furnished by the Federal reserve banks from time to time and show the required number of days before an item on any point becomes reserve funds

As stated under Chapter IX, check collections are now made through the Federal reserve banks on all but about two thousand banks and trust companies in this country. The use of the Federal banks is optional,

It is for the transit manager to decide whether he will send the item to the Federal reserve bank of his own district or to the one nearest the point drawn on. There would usually be one day's time saved by using the latter. Each Federal reserve bank thus gathers checks from many sources and sends them in one letter to its member or non-member clearing banks, charging the same to the account when the proper time has elapsed to effect payment according to the time schedule.

CHAPTER XX

FOREIGN EXCHANGE AND LETTERS OF CREDIT

The banker who handles the foreign exchange department of his bank is, in my judgment, the most brilliant of all in the profession of finance. He must not only be a good banker, but also an economist of world-wide vision, a reader of current events, a politician, a diplomat, keen at mathematics, and with a world-wide knowledge of geography and the peoples of the earth, their customs and their financial condition. One has but to talk with, or better, listen to, a man of this type to become, not simply impressed, but astounded at his wealth of information, statistical, practical, political and financial. And if any department of banking invites all that is highest and broadest and best in finance, it is the foreign exchange part of a bank's operations. We must therefore approach such an intricate topic with due appreciation of its difficulty.

The chief tool of the foreign exchange banker is the bill of exchange, with which is closely associated the letter of credit, shipping documents, insurance and consular invoices, and on these all foreign exchange rests. Let us, therefore, first get a clear idea of what a bill of exchange is.

Bill of Exchange Defined.

A bill of exchange is an unconditional order in writing signed by the maker (drawer) addressed to a third party (drawee) directing him to pay to or to the order of a second party (payee) a sum certain in money on demand or at a designated future time.

A bill of exchange, to be complete, must be (a) An

order; (b) it must be signed by the maker, (c) it must be unconditional, (d) it must name the drawee with certainty, (e) it must be payable in money and the sum must be *certain*—that is, the amount must be stated or possible of computation from the instrument itself (An order to pay “the amount due” would be a *certain* sum, but not a *sum certain*. An order to pay the interest on \$1,000 for six months at 6 per cent would be both a *sum certain* and a *certain sum*. The law has well said that a negotiable instrument must be a “carrier without luggage”), (f) it should be dated, (g) the time should be stated with certainty—demand, on a day named, or a certain number of days or months after date or sight, (h) it need not contain the words “value received”, (i) where the law so requires, it should have the necessary documentary stamps attached

Use of Bills of Exchange.

Bills of exchange are used in large numbers in both domestic and foreign business transactions. Whenever merchandise is sold in a foreign transaction, the seller draws a foreign bill of exchange on the buyer covering the amount, and in buying and selling in this country in the wholesale trades, domestic bills are drawn. They can best be illustrated by example.

A silk merchant in Japan contracts with a Paterson silk mill to sell it a certain quantity of raw silk at a given price. The terms are three months. The Paterson mill arranges with its bankers for a letter of credit, which guarantees the payment of the amount upon arrival of bill, accompanied by shipping documents, invoice and insurance papers. This letter is sent to the Japanese merchant, who loads the silk on board ship, secures the shipping bills and insurance, and attaches them to a bill of exchange which he draws on the Paterson

silk mill or bank named by it. The bank in Japan will discount this bill for the merchant, and he has immediate use of his money. The Japanese bank will forward the bill to its New York correspondent, which in turn will collect from the silk company. Wherever the bill goes, the control of the silk follows, and the Paterson company cannot obtain the silk until it honors the bill. As soon as the bill is accepted, or paid, as the case may be, the papers will be released and the goods may then be taken possession of.

In a domestic transaction the details would be as follows. A flour merchant in Duluth sells a quantity of flour to a New York firm, to be paid for on arrival of the goods. He loads the flour, secures the bill of lading, draws his draft on the buyer and lodges the same with his bank. The bank will advance the money and send the draft to its New York correspondent for collection. As soon as the New York merchant takes up the bill he may unload the flour. The bill of lading is released as soon as the bill is honored, and without the bill of lading the merchandise cannot be had.

Foreign and domestic bills arising out of such dealings appear in large numbers in banking circles and form a large part of the work of the bank. They are handled in the collection department, and are further discussed under that head.

Types of Bills.

The instruments used in foreign exchange transactions are

- 1 *Commercial Bills* These are bills drawn by sellers upon buyers and are known as "documentary bills," if documents are attached, and "clean bills" where no documents accompany. They may be either time or demand, usually the former.

2 *Bankers' Demand Drafts* These are simply drafts drawn by a bank in this country on the foreign correspondent with which it has an account, and are in the nature of international checks. Thus if I were to remit a thousand pounds to London, instead of sending the money, I would simply go to a foreign exchange banker, or the foreign exchange department of a bank, and pay for a draft for the equivalent of a thousand pounds at the then existing rate

3 *Transfer by Letter* This is a draft on a bank in the form of a letter directing it to pay to the designated party, upon identification or other condition, the amount named, and to charge the same to the account of the issuing bank.

4. *Cable Transfers* These are cable messages directing the foreign bank to pay or credit an amount to the party named. They are obviously quicker than the mails, but more costly. In addition to the cost of the cablegram must be considered the fact that the banker has no use of the funds drawn against abroad, since they are demand obligations and the element of time does not enter as in a banker's draft. It is obvious that the bank balance abroad cannot be affected until the draft is presented in a banker's transfer, which will be at least the sailing time for the fast steamers, plus a day or two on the other side, while a cable message will probably be cashed within a few hours of its transmission. Therefore the cable rate is higher than the banker's check rate

5 *Bankers' Long Bills* These are bankers' drafts drawn at 60 or 90 days. They are used by debtors having idle funds and who wish to anticipate their debts abroad

6 *Finance Bills.* These are drafts drawn for the purpose of transferring funds from one money center to another for investment. Thus if a bank in London has

idle funds which it wishes to invest in the New York market, it will instruct its New York correspondent to draw a bill on it, and sell in the market, and invest the proceeds for its account.

The Basis of Exchange Rates.

The basis of exchange rates is the price of the gold unit of one country expressed in the money of the other. Thus the gold unit of England is the pound sterling. The price of the gold in a pound sterling expressed in dollars is \$4 8665, which is the *mint par of exchange*. In other words, \$4 8665 at any United States assay office will buy the same amount of gold as there is in the English pound sterling, or the sovereign. The exchange rate centers around these figures in normal times within a few cents, but the financial disturbance of the war has had a marked effect upon exchange rates between all countries, and they have fallen to unheard-of low levels.

In other words, the English pound contains 113 002 grains of pure gold, the United States dollar contains 23 22 grains. By dividing the one into the other we get \$4 8665 as the mint par, but this is not the commercial par, which is the current rate of exchange. The mint par is fixed; the commercial par varies with the supply and demand for bills.

If the supply of bills is large, the price will naturally fall, owing to the lessened demand, but if the supply were short and the demand large, the price would be bid up until it might become cheaper to buy the gold and ship the metal itself rather than pay the price asked. This *gold export point*, as it is called, arises when the price of exchange reaches a point where the cost of the gold plus the freight, loss of interest in transit and insurance is less than the exchange rate. This has not occurred in this country since the war broke out.

The Demand for Foreign Exchange

The demand for foreign exchange, or drafts drawn on foreign countries, arises from the following sources

1 The need for bills of exchange with which to pay for merchandise purchased abroad

2 The need for bills of exchange with which to pay for securities purchased by us in other countries

3 Remittances to pay interest on American securities held abroad, which before the war were in large volume

4 Remittances for freight and insurance payable to foreign companies, earned here but due to the parent companies abroad

5 Tourists' expenses, which in ordinary times run into large amounts

6 Remittances to Americans living abroad, but drawing their income from American sources

7 Bills to be used in payment of maturing obligations held abroad

8 Remittances by immigrants to home countries

9 Gold movements

Banks doing an international business and desiring to keep balances in various countries must create these balances by buying drafts in this country payable abroad. They therefore go out into the foreign exchange market, which consists of a limited few large banks and banking houses in New York and other large cities, and purchase drafts that are offered for sale. These are sent to their correspondents to be collected and credited to their account. Against the balances so created they sell their bankers' time and demand, or sight, drafts.

Factors in Exchange Rates.

The most important factor in exchange rates is the movement of merchandise. If our importers are bringing in large quantities of merchandise, it follows that there will be a demand on their part for bills with which to make payment, and the price of bankers' bills will go up. If, on the other hand, exporters are shipping large

quantities, so that the balance of trade is in our favor, there will be an abundance of bills offered, drawn on the country of shipment, thus depressing the price

Other factors also affect the rates for exchange, as is illustrated in the case of England. English ships sail every sea, gathering freights from all parts of the world, which must be remitted to the home office. Likewise her great insurance companies cover the world, and the premiums must be sent home. These have a large bearing on the course of exchange.

Before the war, France and England were large holders of American stocks and bonds. The interest and dividends had to be remitted periodically, and provision made for maturing obligations, together with sales and trades. Remittances to cover travelers' expenses and money sent back home by immigrants create a demand for foreign exchange in this country, which adds to the rates in accordance with the volume of the sendings. If, for instance, the Italians in this country send large amounts back home, there is created a demand for drafts drawn on balances abroad to cover them. These drafts must arise from export selling in the Italian market, and the demand for bankers' drafts creates a demand for merchandise drafts to meet them.

The placing of loans in foreign countries also sends rates up or down, for the funds must be sent from the place of sale to the place of issue. Thus, if France is placing a loan in the American market, the American bankers must remit the funds to France. Thus they do by establishing a credit here against which the French bankers may draw their drafts.

It is a principle of finance, easy to comprehend, that money flows to a favorable market. It seeks the highest interest rates. If the money rate in Paris is 6 per cent.

and in London 5 per cent, English money will flow into France for investment at the higher rate. The French banks in this case will draw on the London banks, sell the bills, and loan the proceeds. This would depress the French market by bringing in new funds.

Bills arising from such a transaction are termed "finance bills," and when the loan matures the borrowing bank is obliged to go into the market and buy bills on the lending country to make repayment.

Gold Movements

The gold shipment point arrives when the rates for exchange rise to such a figure that it is cheaper to ship gold than to pay the price for bills. Thus, if the supply of bills in our market is low, so that rates are high, and the banks here find themselves in need of funds abroad which they cannot build up cheaply by buying bills, it will be profitable to ship gold.

If, for instance, when times are normal, the price of English exchange rises to \$4 91, it will be cheaper to buy gold at \$4 8665, pay the freight, insurance, packing charges, and lose interest from the time of departure to time of credit abroad, than to pay the \$4 91 rate, for the total costs may not be over \$4 90 per pound, and this would be a *gold movement against us*. Normally exchange rates fluctuate between the gold import and the gold export point.

Foreign exchange was formerly quoted in different ways, the pound sterling in dollars, marks in cents, and francs at so many francs to the dollar, but recently the bankers have succeeded in having all foreign exchange quoted in dollars and cents, so that at present the quotations give the value in American money for all the currencies of the world.

There are several forms of exchange, each being

quoted, such as cables, demand or bankers' checks, and 30, 60 and 90-day bills. While the cable rate is the highest, it gives the sender the use of his money up to the last moment and the benefit of any change in the market in his favor, taking advantage of any downward movement in the meantime. The banker's reason for a higher cable rate is the fact that the funds are charged against his account shortly after the message is cabled, and he does not have the use of the funds during the intervening period as is the case in using the mails.

Letters of Credit.

Letters of credit play an important part in the commerce and finance of the world. They are the supporting pillars of the international bridge of credit, of which bills of exchange are the ties and cross pieces.

Letters of credit are merely instruments in writing, issued by a bank, on request of a customer, which authorize a seller to draw bills of exchange on itself, or one of its correspondents for its account, under certain stipulated conditions.¹

The chief virtue of the letter of credit lies in the fact that the seller is relieved of the responsibility of extending credit to the buyer, and of the burden of carrying the financial load. The responsibility, once the letter is issued, is solely upon the bank which grants the letter, and which is best fitted to judge the risk assumed in such instrument. Moreover, with such a letter, the seller may have immediate payment for his goods, and therefore is selling for cash.

But the seller is not alone the beneficiary of this instrument, the buyer having likewise many benefits from its use, namely, he does not have to finance his imports until he receives the goods, and if he buys for

¹ "Practical Bank Operation," Langston, p. 373.

manufacturing purposes, can take the goods out on trust receipt and turn them into salable merchandise and sell the finished product, it may be, before the debt becomes

THE NATIONAL CITY BANK OF NEW YORK Signature of beneficiary	No. _____ APPLICATION FOR LETTER OF CREDIT Date _____ 19__ THE NATIONAL CITY BANK OF NEW YORK NEW YORK CITY Dear Sirs: Please issue your Letter of Credit
THE NATIONAL CITY BANK OF NEW YORK Signature of beneficiary	to favor of _____ (Name of beneficiary) for _____ (Amount in words and figures) good until the first day of _____ for use in _____ (State territory the credit is to cover) to be sent _____ (State for, to, and from City and address) Remarks _____
THE NATIONAL CITY BANK OF NEW YORK Signature of beneficiary	<p>The undersigned hereby agree that in case the said Letter of Credit or any renewal or extension thereof is either lost or stolen, immediate notice thereof shall be given you by telegraph and in case of such loss or theft the undersigned hereby undertake you to take such precautions as you may deem advisable for the prevention of fraud and agree to provide immediate reimbursement for all expenses in connection therewith and for all payments made in reliance upon the said Letter of Credit, before actual notice of the loss thereof shall have been received by the person making such payments.</p> <p>In reimbursement of all payments made under the above requested Letter of Credit together with your usual charges you will please</p> <p>(*) _____</p> <p>Yours very truly</p> <p>(*) Please send one of the following instructions: 1. Cash shall be paid. 2. Cheques are accepted with a two year period of date. 3. Cash on delivery for cash.</p>

FORM 35 — Application for letter of credit

due. He also has the assurance that the goods will be as represented and properly covered by insurance while en route

That the issuance of letters of credit is profitable needs but the mention of the fact that the bank sells only its credit, until it is obliged to redeem its promise in cash, for which it collects a commission. In fact the selling of any instrument of credit which involves no outlay of cash is a profitable banking transaction. It is like being paid for indorsing a note—subject, of course, to the risk of loss.

Sterling Credits Versus Dollar Drafts

Under the régime preceding the Federal Reserve Act, importers in this country were obliged to finance their imports by letters of credit drawn by English banks and payable in sterling. It is estimated that the cost to American importers ran into the millions yearly, since they paid a double commission, one to the local bank for arranging the credit and the other to the London bank granting the credit.

The reason for this was the fact that the National Banking Act did not permit national banks to make acceptances, although some state banks and trust companies were permitted to do so. Under the rules of the Federal Reserve Act, member banks may now accept drafts which arise from the import or export of goods, or the domestic shipment of goods which are covered by bill of lading, or if the credit is covered by marketable goods in storage, or if drawn to furnish dollar exchange—which means drafts drawn payable in dollars.

The amount which a national bank may accept is limited to 50 per cent. of the capital and surplus, unless by special permission of the Federal Reserve Board, when a bank may accept up to 100 per cent. of its capital and surplus. In no event may domestic acceptances exceed 50 per cent. of the capital and surplus. Accept-

ances must not run over 6 months, and the amount accepted for one firm or corporation must not exceed 10 per cent. of the bank's capital and surplus, unless

Guaranty Trust Company of New York
Circular Letter of Credit

No 00000 P100-

New York Sept 1 1921

Gentlemen

We beg to introduce to you and to recommend to your records our
Johnson Evans in whose favor
we have opened a credit of One hundred pounds
London's Working and where drafts to that extent will upon the
Guaranty Trust Company of New York London.
21 Lombard Street

Our engagements shall meet with due honor for a period of Six months
from this date.

The amount of each payment is indicated on this letter and your
negotiation of the drafts will be considered as guarantee that the requisite
endorsements have been made.

You will please observe that all checks drawn against this letter must be marked as "Drawn
against the Guaranty Trust Company of New York Letters, Pk note No 00000"

This letter must be attached to the last draft drawn

We remain Dear Sirs,
Yours faithfully,

Signature of Johnson Evans John Doe

SPECIMEN

To Messrs. P. & Co. Correspondents

FORM 36—Circular letter of credit

the excess over 10 per cent. is covered by security. This limitation does not include loans and discounts made under the provisions of the National Bank Act. Drafts drawn for the purpose of furnishing dollar exchange may,

by special permission, amount to 50 per cent of the capital and surplus, and must mature within 3 months.

The advantage of the dollar credit over the sterling is due to the fact that the buyer is dealing in a known quantity, rather than taking a speculative chance on the rise and fall of foreign exchange rates. He sells for dollars, and therefore should buy for dollars.

Bills of exchange are termed "documentary bills" if documents accompany, and "clean" if no bills are attached. In the former certain instructions must be met before delivery of the bill can be made, while clean bills carry no baggage. Documentary bills are used in shipments of merchandise, while clean bills are used in transfer of funds.

The documents attached include the commercial invoice, the consular invoice, the bills of lading, and at times, such documents as pure food certificates, certificates of weight, analysis, certificate of origin, etc.

At times it becomes necessary for the foreign bank to assist the shipper in getting his merchandise to point of embarkation. In such cases it will advance funds under the letter of credit, but safeguards itself by warehouse receipt, trust receipt, etc., which protects the interests of itself and correspondent.

Operation of Letter of Credit.

The operation of a letter of credit can best be understood by tracing an actual case. A bag manufacturer in Kansas City, Missouri, orders burlap from Calcutta, India. The dealer in India wishes to receive payment in rupees or some other currency readily convertible into rupees. Sterling being of the latter type, the letter will be a sterling credit. The importer makes his application to a New York bank direct, or through his Kansas City bank. He may be in good credit standing

and be granted the credit on his general net worth, or collateral may be required. The New York bank will then draw its letter of credit, authorizing the exporter in India to draw drafts in sterling at 90 days' sight on the London correspondent of the New York bank. The New York bank notifies the London bank of the issuance of the letter (banks have reciprocal arrangements for such purposes, the New York bank in this case guarantees the London bank for the risk) and forwards the original and duplicate to the Kansas City merchant, and the triplicate to the London bank. The importer forwards the original letter to the exporter.

Upon receipt of the letter of credit the exporter prepares his shipment in conformity with the conditions named in the letter and draws his 90-day draft on the London bank, and presents it to his local bank for discount.

The draft being in due form, and the documents likewise, the exporter's bank will advance the amount at the current rate, less the discount, and he is out of the transaction except under his liability as drawer of the draft.

The Calcutta bank will send one of the sets of documents to the New York bank and the other to its London correspondent for presentation to the bank drawn on according to the letter. After acceptance the draft may be sold in the open market and proceeds credited to the Calcutta bank, or it may be held until maturity for its account.

When the draft is presented to the London bank acting for the New York bank, it will refer to the advice received from New York, and if in conformity therewith, it will accept the draft and advise the New York bank of the acceptance, attaching the shipping documents to its letter of advice. The New York bank, upon arrival of

the goods, will release the goods to the importer under a trust receipt. At maturity, the London bank will charge the New York bank with the amount, the latter having been reimbursed by the importer.¹

Where the draft is drawn in dollars, as has been the growing custom since the war, the exporter would draw directly upon the New York bank, thus avoiding the London transaction and the double fee for handling the operation.

It is obvious that before making an acceptance of such a draft, the bank should be exceedingly careful that the documents and details of the transaction are in due form as required in the letter of credit. The bank does not enter into the contract of sale, the quality or quantity of goods, unless so agreed, when an appraisal is had. If the documents are not in due form, they are held over until the wishes of the importer may be ascertained and the discrepancies rectified or adjusted.

When a bank accepts a dollar draft, as mentioned in the paragraph above, the acceptance is entered in an acceptance register which records the number, date, amount, maturity, drawer and address, letter of credit number, for whose account, by whom presented, and the goods covered. After examination and recording, the document is accepted by an officer of the bank and becomes a banker's acceptance, and is included in the item "Bank's liability on account of acceptances outstanding," in the statement. If the draft is purchased by the bank itself, the correspondent bank would be credited, but if presented from another bank, a cashier's check would be issued. When the acceptance is due according to its due date, it will be presented for payment, either over the counter or through the clearing house.

¹ Adapted from "Practical Bank Operation," Langston, pp. 388, 389.

A *circular letter of credit* is one payable at various banks, named in the letter. These include banks in all large cities throughout the world and their branches. But under a "dollar circular credit" it is payable only at the bank of issue. In the circular letter a list of correspondents is furnished, and these will honor drafts drawn against the original letter.

There is also the "clean credit," which consists of a credit opened by one bank in another for the account of a customer, by which the correspondent bank is asked to honor checks drawn by the customer up to the stated sum. Such credits may be payable in a single sum, in installments, or periodically.

Obtaining a Letter of Credit.

In obtaining a letter of credit, the customer fills out application blank, giving the full details of the transaction, such as beneficiary, amount, time to run, where used, and through what bank or banks the funds are to be paid. Specimen signatures are also furnished. If it is a cash transaction, no credit investigation is made, but if a guaranteed credit, or supported by collateral, the credit standing of the applicant, or the value of the collateral, is looked into before the issue of the letter.

The letter is then made out, in duplicate or singly, as may be the custom of the bank, and given to the customer.

Where the letter is guaranteed, the guarantor is required to sign a form which guarantees the bank for the amount of the credit plus commission and interest paid on the drawings from time of cashing the same until reimbursement by the paying bank. In other words, the paying bank collects from the bank of issue interest for the time it is out of the funds, as compensation for the use of the money.

The Trust Receipt.

The release of goods consigned to importers, under trust receipt, is a common procedure. The trust receipt in brief acknowledges the receipt of the goods mentioned, and the maker agrees to use them as the property of the bank; and in whatever form they may be manufactured, they remain its property, as well as the proceeds of any sales made therefrom. The risk is largely moral, and a breach of trust is a conversion of property.

The obligation of a bank making an acceptance is absolute, and it must pay the holder in due course, and if the acceptance is made by a foreign bank for its account, it must reimburse the foreign bank on the day the acceptance is due. Acceptances falling due are given the same care as notes maturing, and the obligor is notified in time to make his arrangements accordingly.

The advantage of having dollar drafts drawn is the fact that the importer knows exactly what amount he must pay on the maturity date, while in foreign money he must take the risk of exchange rates, which may be higher than when he made his contract of purchase, and he has the double risk of the market at home and the exchange rate at the time of making his payment.

Varieties of Letters of Credit.

There are two kinds of letters of credit in respect to the drawings allowed against them—the fixed and the open—the former being for a definite sum, within a definite period, and the latter allowing the seller to draw upon the bank within a given time up to a fixed amount at any one time.

The Work of Letter of Credit Department.

The work of a commercial letter of credit department divides itself into three sections (a) The department that issues the letters. Before this is done, the credit investi-

gations must be made, the credit terms ascertained, the credit approved by proper officers, arrangements made with the customer and the foreign bank, and the records made pertaining to the credit. (b) The examination and delivery of the documents Inasmuch as the credit is conditional, the papers in connection with the drawing must be in conformity with the conditions before the drafts can be accepted (c) Collecting from the importer and settlements with the foreign banks

Process of Issue

The issuance of a letter of credit being an agreement to honor drafts drawn upon itself for account of a customer, the bank therefore assumes the direct obligation of meeting the same, and in this sense letters of credit are equivalent to a loan, excepting the fact that the bank parts with no cash It merely sells its credit.

The application for a letter of credit is equivalent to an application for a loan, and covers the amount, drawer, for whose account, time to run, and merchandise covered by the credit, documents to accompany, insurance, etc

There is next prepared an offering slip showing the outstanding liability of the bank on similar letters for the same party, goods out on trust receipt for the same account, unused credits in former letters, and documents held by the bank covering current shipments not yet disposed of

After the credit is approved and the records of approval filed with the letter of credit department, there follows the drawing of the letter itself These letters are drawn in dollars and pounds sterling, the former now fast coming to the front

The customer agrees with the bank to furnish it with funds to meet the drafts drawn against the credit, if drawn payable in dollars, at least one day before ma-

turity; and if drawn in sterling, at least 12 days before maturity if he wishes to pay the check rate of exchange, and if the cable rate, at least one day prior. He may also agree to remit a demand draft in time to reach the foreign correspondent on or before date of maturity. He also gives the bank a lien upon the goods and absolves it from losses beyond its control. He may also be required to give security before the bank will surrender the documents.

The letter of credit can best be understood by a reading of the form on page 316, which contains the usual clauses. Where the credit is payable in foreign currency, two copies are given to the customer, one for him and one for the shipper, one is sent to the bank acting as the accepting agent abroad, and one copy of course is kept for the files of the bank. Where haste is required the terms may be cabled to the various parties.

Export Letters.

For the same reason that the exporter in a foreign country makes certain demands as a condition for entering upon a bargain and sale of goods to an importer in this country, the exporter in this country makes certain demands upon the foreigner buying in this market. And as a bank in New York establishes credits for buyers here, so foreign banks establish credits for their buyers. The bank that acts for the importer also acts for the exporter, in one case it pays his commitments, and in the other it sees to it that he gets paid for the goods he sells. Where, as obtained during the war, the American merchant was the world's largest seller, it follows that export credits have taken an important place in foreign trade. The whole world wants our goods, so it naturally follows that we can name the terms, these terms, however, being subject to customs

heretofore in vogue and which cannot easily be changed. But, having something that the other peoples need and must have, we are able in a measure to name the terms. However, as reconstruction progresses and other nations begin to bid for the world's trade, we shall have to meet competition not only in quality and price but in financing arrangements.

The exporter desires to know that his draft will be honored abroad, and to this end there is the guarantee credit, whereby the exporter's bank, on the strength of the guarantee of a foreign bank, advises the exporter that his draft will be honored abroad. The American bank assumes no liability. The exporter must receive his pay from the bank issuing the credit abroad, or from the buyer. Under a second method, the exporter's bank issues its own guarantee that the export draft will be honored abroad.

Operation of an Export Transaction.

The export phase of a commercial credit transaction consists of four operations:

- 1 Receiving of credits opened
- 2 Informing the exporter of the credit
- 3 Making advances to the exporter as he uses the credit
- 4 Reimbursing the bank for these outlays ¹

As in an import credit the New York bank advises the foreign bank that a credit has been opened, so in an export credit the foreign bank will advise the New York bank that the credit has been opened. These advices may either be by mail or cable. The authenticity of the signatures to these letters must of course be tested, to ascertain that the credit is *bona fide* and binding upon the bank issuing the same, and it must also be

¹"Practical Bank Operation," p. 403

known to what extent the bank has obligated itself in this manner

The exporter is advised that the credit has been opened, and of the amount and terms of the same. The foreign bank is also advised that the credit has been opened on this side. Card record is made of the credit to inform the bank officials of the total credits opened for each customer, just as a record is kept of the credits opened in an import credit. These cards record the details of each shipment and payment made under the credits, so that the bank may know how much of these foreign credits the customer is using.

Changes in the amount and terms of credit are often made by cable after the original credit is opened, and these changes are noted on the exporters' cards to keep the credit information up to date.

When the American shipment is ready to go forward, the exporter prepares the documents, draft, bill of lading, invoices, etc., and presents them to the bank.

The documents are then compared with the advices of credit to see that they conform to the terms of the credit. These documents are given minute inspection to see that they conform exactly with the terms of the letter, lest the importer on the other end refuse the shipment and thus throw the goods back upon the market, with all the attendant dangers and annoyance.

If the documents are in due form, the bank will credit the exporter, if a customer, or if not, make payment by its own cashier's check or otherwise, depending upon the circumstances of the transaction. The bill of exchange and documents are then sent abroad for acceptance or for payment as the case may be. These drafts are always made in duplicate, one being sent by one steamer and the other by another, so that in case of disaster at sea, both will not be lost.

Where the goods cannot go forward immediately, they are often stored until steamer sailing time, or advances made upon the domestic bill of lading. If such export goods go into warehouse, they follow the routine of a warehouse loan, until released for placing on board ship, with insurance, warehouse receipt, etc., running to the bank. When the goods leave the warehouse, they are covered by trust receipt until ocean bill of lading is issued. In short, the bank never loses its claim upon the goods, wherever they may be, safeguarding itself by the methods suggested above.

In making such an advance against an export of goods, the bank, upon crediting the customer, will debit the foreign bank to which the bills are sent, or hold the same as a time asset for collection, under the heading "due from banks." Should the New York bank, upon receiving such an export draft, elect to accept it rather than make payment in cash or by credit, it may then be sold for the exporter's account in the open market. The bank will credit the account "acceptances outstanding" and enter the same in an acceptance record similar to the one previously described. The offsetting entry will be in "customer's liability on account of acceptances," and when the acceptance matures the New York bank will reimburse itself from the foreign bank which originally opened the credit for its customer.

Commissions for such accommodation are collected from the beneficiary, and all expenses, such as cables, exchange, etc., are charged against him.

Travelers' Letters of Credit

One of the principal sources of foreign exchange is the traveler's letter of credit. This is an instrument issued by a bank to an individual contemplating a trip abroad,

which by its terms agrees to pay drafts drawn by the holder on itself or any of its correspondents up to the amount stated therein. The holder presents the letter to the bank in the place where he is sojourning, and draws a draft, which the bank will cash and indorse the amount drawn on the letter. It would be the same transaction if the bank were to agree in writing to honor the checks of a customer up to a certain amount. They are a most convenient form for carrying funds while on a journey.

Illustration of the Use of a Traveler's Letter of Credit.

A traveler holding a traveler's letter of credit desires funds in Italy. The correspondent of the bank of issue is named for the place in question, and the traveler presents his letter to it. The Italian bank prepares a draft on the bank of issue, which the party signs. The banker then advances the equivalent for the amount drawn, making a notation of the drawing on the letter. The draft is then sent to the bank drawn on for payment. If the letter is drawn payable in London, for the account of the New York bank, the London bank will be drawn on, it having advices of the credit as a guide in honoring the drafts presented. When these are presented, they are charged to the New York bank and sent forward for redemption or reconciliation. The payment in such a case would be in lire at the rate existing between London and the Italian city.

There are three methods of securing the accommodation underlying the letter of credit: (a) Payment in cash, by which the bank assumes no other obligation than to pay for what it has already received, as in a deposit. (b) Payment under guarantee, which is given by a bank, individual, firm or corporation, which guarantees that the drafts will be paid as presented, and is in substance a guaranteed unsecured note. (c) Pay-

ment which is secured by collateral, which is in effect a collateral loan.

The commission for letters of credit is usually one-half of 1 per cent of the amount. Where cash is advanced on letters of credit, the interest for the time between the advance of the funds and the time of reimbursement in New York funds is added at the rate of 6 per cent. in addition to the commission.

Traveler's letters of credit are also issued payable at one bank only, and are used where the owner expects to remain in one place. They are of course not current in other places, but may easily be canceled or payment stopped, for obvious reasons. These are called "special letters of credit."

Travelers' Checks.

For many years past the great express companies, travelers' agencies and banking houses have been issuing travelers' checks, good in practically all parts of the world. They are issued in denominations of \$10, \$20, \$50 and \$100, and are signed by the buyer at the time of purchase and again countersigned at the time of cashing, which signature must agree with the one already made. The travelers' check is in substance a safeguarded bank note, and is payable in whole, in contrast with the travelers' letter of credit, which is payable in part. The "A. B. A. Travelers' Checks," issued by members of the American Bankers' Association, through the Bankers Trust Company, and widely advertised, are now the most common form. They were formerly payable at fixed rates of exchange in foreign countries—that is, so many pounds in England, or so many francs in France, for each dollar. But, owing to the disturbed condition of foreign exchange due to the war, they are now payable in dollars only, and made convertible into foreign money

at the buying rate for bankers' sight drafts on New York at the time and place of cashing.

Travelers' checks are not only cashed at banks, but are freely accepted by hotels, steamship companies and business houses in general. They are in substance international currency. In cashing them the owner must sign in one corner with the same signature as used when taking out the checks, thus safeguarding them from forgery.

When a letter of credit is paid in full, it is returned with the draft that exhausts the credit. Unused letters which have expired by limitation of time may be extended.

Lost letters of credit may have stop payments lodged against them, by cable or mail, using the former for places where the letter is liable to be first presented if stolen, and the latter for more remote places. In replacing such a lost instrument the bank will require a bond of indemnity. Drawings against letters are charged to the account representing the credit first established, thus reducing the bank's outstanding obligations, and in the case of travelers' checks are charged to the "travelers' check fund." If on a guarantee of payment, the guarantor is notified of the payment and reimbursement is made by check or in cash.

Caid records of these credits are made, crediting the amount, if in cash, and charging drafts as presented, so that the outstanding amount of the credit may be known at all times.

Travelers' checks are listed in books, with number, to whom issued, date, when paid, etc., and when sent to correspondent banks, the numbers are recorded as open checks out for sale and properly accounted for from time to time.

Letters of credit issued by foreign banks and redeemed

in this country will follow a reverse process as herein treated

The cash received from the sale of the travelers' checks is carried to "cash letters of credit account" and is a demand obligation the same as a cash deposit, and so set up, and the bank not only has use of the funds, but also the commission as its compensation for the service

The small banks handle too little of this business to operate a system so world-wide, and therefore issue their letters through the city banks. The city banks furnish the correspondent banks with proper forms, ready for filling. When they are issued by the country bank, the city bank is notified of the issuance, with numbers and amount, and name of the party purchasing, together with specimen signatures as a means of identifying the checks drawn against the credit. The account of the correspondent would be charged with the amount of the credit.

The Foreign Exchange Department.

The foreign exchange work of a bank requires a highly specialized force by reason of its intricacies, for which the foreign-born seem to have special aptitude. Not only is a vast amount of detail work required, but also a knowledge of the currencies of the world and the daily fluctuations in the rates. It is far from a matter of merely dealing in dollars and cents. This work is a department solely by itself, and is complete in itself.

The applications for exchange come in through the windows and through the mail from correspondents, and if urgency is in order, by telegraph or telephone. The remitter is required to fill out an application blank, giving the name of the payee, place of payment, address in detail, amount to be sent, and name and address of

sender, and also the currency in which payment is to be made

The department also deals in foreign money, buying and selling the same at current rates, and handles foreign business operations for the customers. Usually the drafts are drawn payable in the currency of the country where the payee does business, so that the exact amount to be received is known both to the sender and the recipient.

All computations are carefully checked to insure accuracy, and names and addresses are likewise closely examined.

The accounting in the letter of credit department differs in no essential from the work of the note teller. There is the liability record of each customer operating under letters of credit, corresponding with the liability book of the note department.

Record is kept of all outstanding credits issued, to indicate the amount of obligations outstanding, which is the difference between the credit issued and the acceptances made thereunder. There will be, of course, portions of letters unused, forming a contingent liability.

Large banks also keep a record of the value of imports brought in under their letters of credit (foreign letters being converted into dollars for uniformity in pricing), the total letters issued and the amount of exchange required for future covering of credits maturing abroad, etc., for statistical and informative purposes.

Domestic Acceptances.

A domestic acceptance is one arising in and payable in the same country. A New York bank will establish a credit covering a shipment of wheat from Chicago. The Chicago merchant will load the wheat, secure his bill of lading, draw his draft and attach the bill,

handing it to his Chicago bank. The latter will send it to New York for acceptance or payment. The Chicago bank may advance against the draft and credit the customer, it being in turn reimbursed by the New York bank. If the goods are for export, they will be covered by the bill of lading from Chicago to New York, by the elevator receipt while in New York awaiting loading, and when on board ship by the ocean bill of lading.

It will be seen from the foregoing that the bank is the financial medium through which are financed these foreign dealings as well as domestic, the security being the goods themselves. And thus the burden of carrying the credit load falls upon the banks, where it belongs, the merchant having to do solely with the merchandising end, which is his particular function and calling.

CHAPTER XXI

MISCELLANEOUS ACTIVITIES OF A BANK

Building up a Bank Organization.

The work of building up an efficient organization for a bank is a task of no mean proportions. In the larger banks a personnel department is operated which has to do solely with the employees and their welfare. This includes engaging, assigning and promoting the employees as they grow into usefulness and efficiency, together with the bank club, educational work, and care for the sick and the unfortunate.

Applicants, from whatever source they may come, file a standard form of application blank, with references. The department looks into the qualifications, education, home life, etc., of the applicant and places the acceptable names on the available list. Some banks employ "man analysts" who interview applicants and make recommendations as to their fitness and peculiar aptitude for special work. When help is wanted, requisition is sent in, and the likely candidates are sent for and engaged. All employees are bonded at the expense of the bank. There is in some banks an auxiliary force of stenographers and typists who are sent wherever special work requires, as are also other men who constitute the "flying squadron."

Statistics are compiled of employees, their term of service and cause of dismissal or resignation. The personnel department also answers inquiries concerning former employees, who naturally give the bank as reference in seeking new positions.

Banks are now analyzing the various positions, and set up certain standards which fit the employee for service therein. For instance, the bookkeepers must be good penmen, patient, plodding, accurate, and capable of enduring the hard strain of monotonous work. And all cannot claim these homely virtues. A teller must be agreeable in personality, accurate and trustworthy.

Banks keep careful watch of their employees, sometimes having them "shadowed" from time to time to discover their habits. Complete information concerning each is kept in a folder, with original information, specimen signatures, and their working record. All employees are indexed, and the department in which they are employed is indicated on the index card.

The attendance of employees is kept by means of a time clock which all must punch going and coming. Many banks treat their help in the same manner as a factory or other large employer of labor, keeping record of the "labor turnover" to ascertain the merits or demerits of their working plan. The age, religion, sex, time employed and nationality are kept, and summarized from time to time for statistical purposes. Inasmuch as it costs a certain amount to train an employee, every effort is made to make the work agreeable, profitable and steady, on the ground that continuous work makes for efficiency, and a trained employee becomes more valuable as time goes on. Where the employee proves a misfit in one department, he is tried in another, until he finds his niche or is given up as hopeless.

There is also the "bank club" in many institutions, which caters to the social side of the employees, having dances, outings, athletics, etc. Some banks operate co-operative stores for buying household supplies for their men, building and loan associations, and thrift and

savings clubs Pension systems are also operated, which provide pensions for those who serve the bank for a number of years, and welfare work, such as medical and nurse attendance for those in need

The large banks also conduct educational courses for their employees, giving them education in business subjects, English and letter writing, languages (for the foreign field), banking and finance. These are operated in connection with educational institutions and in study classes in the bank

Registered Mail.

Banks are large users of the registered mail, sending and receiving valuable papers, stocks, bonds and coupons by this medium. In the large banks the registered mail is received directly from the post office by trusted messengers, who deliver it to the registered mail department. A record is kept in a registered mail receipt book giving the name of the sender, the number of the registry and when received. It is then distributed to the department in charge and a receipt taken in the book.

All mail, registered or otherwise, is examined to see that it contains what it purports to enclose, and all mail has proper attention, even the circulars that are presumed to be only for the waste basket.

Outgoing Registered Mail.

The banks send out as well as receive large quantities of registered mail. Outgoing registered mail is recorded in a book describing the parcel, and properly sealed in the presence of two or more employees who certify to the contents. The package is then sent to the post office or express office, and proper receipt taken. When the receipt of the addressee is received, it is compared with the book entry and filed for reference.

Regular Mail.

In sending out ordinary mail, all the enclosures for one address are assembled and put in one envelope, thus saving postage. The stamps are obtained from the petty cashier and charged to the department dispatching the mail. A strict control is kept over the stamps, lest there be petty pilfering by the employees having access to them. Foreign mail must, of course, be given special attention, in order that it may go by the first and fastest steamer. Many foreign letters contain bills of lading and other valuable papers which must reach the consignee as soon as, if not sooner than, the goods themselves, and large banks keep a sailing list for quick dispatch of their foreign mail.

The Telegraph and the Cable.

A large volume of banking business is transacted by wire. In general the banks use codes, for the purpose of keeping the messages secret and to cut down the cost, one code word meaning several. Many large banks have their own codes, for use between their customers and themselves, while others use the commercial codes. The American Bankers' Association has a code of its own for use of its members. Code messages incoming and outgoing are carefully read and checked to insure accuracy of translation. The same applies to letters received or written in foreign languages. Outgoing messages are quite generally confirmed by mail, many banks making two or three copies of the message. Many large banks also have private wires connecting with all principal cities. Test words are used to safeguard the bank from spurious transactions by wire, both in sending messages to the bank and in sending messages from the bank. These test words are known only to the sender and in the bank to the test word department. Before acting upon messages they are tested for this safeguard.

Telegraphic Transfers.

Banks are frequently called upon to transmit funds by wire. The customer may order the transfer in person, by letter or by wire. The message is sent under code to save expense and to safeguard the bank from wrongful payment. The transmitting bank will telegraph the bank on the other end to pay to the party named, upon proper identification, the amount named. Advices by mail are also sent to the paying bank and the payee as confirmation of the telegram. A copy of the telegram is attached to the original order as evidence of the transaction, and is stamped with a timestamp indicating the time of the receipt and the time of the execution of the order. Orders to pay, received by wire, are carefully checked with the code book to secure accuracy in translating the code, and are paid by cashier's check or by credit to the payee's account, and advice of payment sent to him as well as the sender. Receipts are taken for all such payments. Transfers of money by wire between banks for their own account are debited and credited the respective accounts with acknowledgment by mail.

Library and Statistical Work.

Many banks are now operating financial libraries and statistical departments in charge of experts. In the library are gathered books on finance from all parts of the world, magazines and periodicals, maps, directories, reports and financial newspapers. These are loaned to employees, and they are encouraged to make free use of them on the principle of a circulating library. In fact, the library is a storehouse of financial information. The statistical department gathers and compiles statistics of all kinds, prepares information on all phases of business and finance, and prepares the bank's publica-

tion, which in many instances is recognized as authoritative

The Work of a Bank Attorney.

In the introductory chapter it was said that a bank proves a desirable client to a lawyer, and many attorneys have been instrumental in forming banks for the legal work that follows. This is true. The large banks maintain a legal department that attends to the incidental legal work of the bank, which covers many phases of the law. There is the legal status of collateral, lost certified checks which require bond of indemnity, deceased person's accounts with all their complications, disputes with customers that involve points of law, payment against stop orders, irregular checks, forgery and alteration, and a thousand and one legal points that come up in a day's business.

In some banks the legal department handles the insurance in various forms, claims under policies, etc. There is also the work of collecting notes that have gone to protest and require legal aid in collecting. Such cases arise constantly, and the attorney finds in these a steady source of profit. There is also the making of searches, drawing of papers and closing titles, always a profitable field. In some cases the attorney works on a retainer and in others on a fee basis.

Commercial Paper Purchases

Many country banks purchase commercial paper through their city correspondents. In such instances the country bank will ask the correspondent bank to invest a certain amount for its account. The city bank then makes the purchase, charges the customer's account and sends advice of debit by mail. The city bank as a rule makes no charge for the service, *and never guarantees the paper*. It merely acts as agent, and on its best

judgment, purchasing only such paper as it would buy for its own account. The payment to the broker is made by cashier's check, and the paper is either sent to the purchaser or held by the bank for its account.

Trust Department.

Since the Federal Reserve Act allows national banks to exercise trust powers, when not in contravention of state law, and many states now give state banks the same right, banks the country over are opening "trust departments" which handle estates, act as executor, administrator, guardian, trustee, registrar of stocks and bonds, and all manner of activities heretofore reserved to the trust companies. A description of the trust department in detail would be impossible in a work of this kind, and the student is referred to works on trust companies for such information.

Foreign Banking.

National banks are permitted to establish foreign branches, provided the bank has a capital and surplus of at least \$1,000,000, and they may invest not over 10 per cent of their paid-in capital and surplus in the stock of any one or more banks or corporations chartered or incorporated under United States laws or the laws of any state and principally engaged in international or foreign banking, either directly or through agencies, ownership or control of local institutions in foreign countries. Some state institutions also have foreign branches.

The National City Bank of New York, the largest national bank in the country, has branches in various parts of the world, and gives a world-wide service to its customers. In its book on "National Banking Under the Federal Reserve System," it thus summarizes its foreign service.

"Since the establishing of The National City Bank of New York's foreign department back in 1897, the bank has tirelessly striven to develop its facilities for foreign banking, to keep pace with the ever enlarging needs of American business men. With the passage of the Federal Reserve Act, which gave American banks the privilege of establishing branches abroad, The National City Bank at once began serving the interests of American trade by the opening of foreign offices. The bank's own branches, and those of the International Banking Corporation (owned by The National City Bank) are located in the principal cities of Latin America and the Caribbean district, throughout the Far East, in South Africa, and at such important European commercial centers as London, Antwerp, Brussels, Lyons, Barcelona, Madrid, and Genoa.

"This world-wide network of branches, supplemented by correspondents in all cities where branches do not exist, places The National City Bank of New York in a unique position for being of assistance to business houses and banks throughout the world that are in any way in contact with the mighty current of foreign trade and makes it possible for the bank to handle all financial transactions, arising from international commerce. Special facilities which the bank's foreign organization enables it to offer include

- 1 Collection of drafts anywhere in the world
- 2 Negotiating or advancing against approved foreign bills, documentary or clean, drawn on any foreign point
- 3 Caring for all phases of foreign exchange transactions, including the sale of foreign drafts, payable in any foreign country; transfer of funds by mail, telegraph or cable, and purchase and sale of foreign currency
- 4 Making available the bank's foreign draft service, under which correspondents draw their own drafts direct on foreign countries for The National City Bank's account
- 5 Acceptance of drafts covering commercial transactions, domestic and foreign, in accordance with the regulations prescribed by the Federal Reserve Board
- 6 Issuance or advice of import or export commercial letters of credit, and of travelers' letters of credit, and travelers' checks
- 7 Gathering and supply to the bank's clients of reliable credit information on foreign firms, and forwarding to the bank's foreign branches correct credit information on American firms
- 8 Aiding in securing legal services in foreign countries
- 9 Study of, and reporting upon, foreign market conditions and possibilities for the sale of American goods abroad

10 Through the bank's foreign trade department, bringing together the foreign buyer and the American merchandiser, and vice versa

11 Assisting customers in disposing of rejected merchandise in connection with dishonored foreign bills

12 Supplying letters of introduction to the bank's foreign branches and foreign correspondents

13 Execution of orders in this and foreign countries for the sale or purchase of securities "

New-Business Department.

Many banks are now operating new-business departments, whose function is to build up the deposits of the bank. A thoroughly organized follow-up system is operated, the "prospects" being interviewed by traveling representatives of the bank. Banks that solicit country-wide business have men in the field all the time, while those who confine themselves to the local field do essentially the same work in the more restricted territory. These prospects are secured through various means, and many banks have lists of the depositors of other banks, obtained by keeping record of the checks that go through their hands from time to time. By taking the checks thus received for a month and making record of the drawers, a fairly accurate list of the depositors of another bank may be obtained. It is quite probable that in the larger cities all banks have such a record of the depositors of the other banks.

This department also has charge of the bank's publicity, which consists of newspaper and magazine advertising and solicitation by mail. The copy is prepared by experts and placed in such publications as will reach the clientele the bank aims to serve.

There are many financial advertising houses in the field, which furnish banks with their copy and booklets, and in many cases handle the entire advertising of the bank under contract.

In the smaller banks this work is done by an official as

incidental to his other duties, but cannot by virtue of circumstances be given the same attention as specialized work affords.

This department not only solicits new business, but acknowledges new accounts and follows up accounts that have closed out, and endeavors to ascertain the reason, in order to correct the errors and misunderstandings that cause such loss of business.

To describe the work of this department would involve lengthy treatment of publicity methods, the preparation of copy and follow-up systems. The student who is interested in this phase of banking will find the subject covered in recent works that treat in detail of bank advertising.

Bond Department.

Many banks now operate a bond department. This department buys and sells securities of all kinds for clients. In some instances the bank joins an underwriting syndicate that handles an issue of bonds or stock and is allotted a certain amount, which it sells to its customers. These syndicates are formed by the great bond houses in the large cities, which agree to market the issue on stated terms, the profit being the difference between the underwriting and the sale price. The bank that enters a syndicate must, of course, take up the allotment, whether it can re-sell or not, and must abide by the rules of the syndicate.

In other cases the bank merely buys securities which it hopes to be able to sell to its clients. Banks operating such departments are always allowed a fraction off the published price, so that they can sell at the offered price and still show a profit.

Where the customer desires to buy or sell securities already on the market, the bank handles the transaction

for him. The order is taken in writing, with name of security, price and details of the order. It is then placed with the bank's broker, who fills the order. If a security is to be bought, the customer must either have an account with the bank or provide for payment in acceptable form. When invoice is rendered the bank will pay the same and charge to "securities for clients" account and afterward to his individual account. When the securities are delivered to the bank, they will be held in reserve for the purchaser and delivered upon proper receipt.

If a security is to be sold, it is left with the bank with written order giving the price. When sold it is delivered to the broker, and the proceeds are either credited to the customer or turned over to him by cashier's check or otherwise.

When the order to buy is for a security that may legally be held by the bank as an investment, it may be treated as the bank's property until paid for and delivered, when payment in advance is not required, but in the case of stocks, which banks as a rule are not allowed to hold, payment in advance, or funds to cover on deposit with the bank, is the general requirement. As a general rule banks do not advise clients in respect to speculative investments, such as oil and mining stocks, preferring to furnish the facts and let the customer make the decision.

Business Information.

One of the noteworthy developments of the past few years in banking circles has been the spread of business and financial information. This is accomplished through monthly business reviews of current conditions, now issued by a great many banks, addresses by bank officials, which are generally circulated in printed form afterward, and special reports and investigations.

Banks have come to realize that business must be done intelligently. The bank can only be safe as its customers are safe. It can grow only as they grow. If the bank can help its customers expand their business at home and abroad, it will share the profits in one way or another.

As a result of the war we have become interested more vitally than ever before in the foreign trade which grew out of war conditions. Our merchants are now reaching out to all parts of the world for trade, and it follows that they can only do so safely if they have full information regarding the standing of their foreign customers, their needs, their peculiarities, their methods of financing, shipping, etc.

Many merchants are too small to carry on an extensive investigation of this sort, and the banks have assumed the task for the joint good of all.

The large banks are now covering the world either with branches or with traveling representatives who study conditions at close range and furnish reports to the home bank covering the countries under review. The same thing is done for all sections of the United States.

These reports cover not only the economic side of business, but special opportunities for trade development as well. For instance, an investigation will be made of the possibility of introducing such an article as a phonograph in a South American country. The investigator will study the customs of the people, and the present possibilities as a field for such instruments and records. If the industry is already established, a review of its history will be furnished, together with suggestions as to its enlargement. Or, if an order is received for a certain article, the foreign representative will check the credit of the buyer.

It is apparent that by stimulating business that would

not otherwise come into being, the bank benefits itself; for as soon as trade begins to grow, there will follow the banking transactions that attend letters of credit, foreign exchange remittances, etc., together with the enhanced balance that the additional volume of business will produce

Trade Reports.

The trade reports furnished by the banks are most comprehensive, and cover such details as the demand and present supply and how obtained, volume of imports from other countries, freights and duties, prices named in other competing countries, comparison of other articles with the one under review, suggestions as to packing and labeling, manner of advertising, and such other details as will give the manufacturer a complete summary of his prospective market, with particular reference to present and possible future competition.

Some banks publish these trade helps in the form of monthly reviews and distribute them to those interested in such subjects, with additional service in the line of information about visiting buyers, opportunities to establish foreign connections, etc.

The large banks are now employing economists as part of their staff, who make special studies in business economics and publish such facts as they may deem helpful to the banks' clients.

The bank also acts as a go-between between the foreign merchant and the American, bringing the two together, furnishing introductory letters to business men traveling abroad in search of trade, or foreign representatives sojourning here in search of business connections. The bank throws its service department open to them freely and acts as their host while in this country.

Banks in New York and other large cities where im-

ports are received will take charge of arriving shipments of goods, have them properly stored, pay the charges, effect insurance, and act as agent of the importer in safeguarding his interests involved in the importation.

In the case of dishonored drafts, merchandise that has not been accepted, or over which a dispute has arisen, or upon which an inspection is desired before accepting the same, the bank will act for its clients, and give the transaction the same care as they would in person.

The bank also acts as agent of its clients in adjustments under fire losses, marine perils, payments under contracts to be performed in this country for foreign buyers, payments under insurance policies, mortgages, etc., also in the delivery of deeds and other instruments that carry with them special instructions that must be carried out as a condition of delivery.

Industrial Department.

Many banks are now operating industrial departments that specialize in business organization. These departments are in charge of experts on factory management, financing plans, accounting systems, etc., that have in mind the betterment of business. These men make surveys of large business concerns, analyze their methods, and make suggestions as to improvements, curtailment of costs, development of markets, and other factors entering into business development.

As an indirect method of advertising, these specialists attend conventions of business men, make addresses, act on committees, and serve as special advisers to the organization in promoting the welfare of its members.

The basic idea in the industrial service is to promote sound practices, eliminate waste, cut down costs, fix fair prices, finance soundly, expand conservatively, buy

cheaply and produce largely, and bring labor and capital into a harmonious agreement. The bank benefits directly in an advertising way, but in a larger way it benefits by providing business with a solid and effective foundation, thus making its banking risks the more sound.

Banks as Insurance Agents.

Under the National Banking Act and under rules laid down by the Federal Reserve Board, national banks in places not exceeding 5,000 population may act as insurance agents, under the following general restrictions.

- 1 The company for which the bank acts must be authorized to write insurance in the state where the bank is located
2. The bank can only solicit and sell insurance and collect premiums
- 3 The bank may receive the agreed commission as agent
- 4 The bank cannot assume or guarantee the payment of any of the policies issued by it
- 5 The bank cannot guarantee the statements made by the insured

Banks as Real Estate Agents.

National banks may also act as agents or brokers in procuring real estate loans, provided the bank is situated in a place of 5,000 population or less, and the real estate upon which the loan is based is not over 100 miles from the place where the bank is located. The bank may not guarantee the payment of principal or interest of the loan. Reasonable fees may be charged for such services.

The Bank as Custodian of Securities.

Since the Liberty Loans placed large amounts of securities in the hands of the public, which had no adequate safeguards for keeping the same, banks the country over have offered to keep these securities, as well as others, for their clients, gratis. Some banks have operated a safekeeping department for years past, in which securities

of all kinds have been kept for customers, either as a courtesy or for a small fee

The customer is given proper receipt identifying the securities by name, numbers, maturity, amount, coupon due dates, etc., which are afterward recorded in a safe-keeping ledger under the same detailed arrangement

As the coupons fall due they are collected and credited the customer's account, or remitted for by cashier's check. This is not to be confused with the trust department, which does the same thing under trust arrangements. The former plan is purely a safekeeping proposition, the bank having no interest in or title to the securities in any form.

When so agreed upon, the bank will give expert attention to the securities of its clients, render statements, attend to conversions, subscription rights, income tax returns, etc., thus relieving the customer of many trifling, yet important details that attend security ownership

Washington Activities.

Under the National Bank Act, certain requirements obtain that make it necessary for national banks to have a representative in Washington for certain purposes, among which are.

- 1 Verifying and counting the worn and mutilated national bank notes, witnessing their destruction, and proving bonds left as security for public funds
- 2 Deposit of bonds, their withdrawal and substitution, which are lodged as security for Postal Savings funds and other public deposits, together with the cutting of coupons attached to such securities
- 3 Transmitting calls for statement by wire
- 4 Searching records in the public bureaus for certain information desired and following legislation affecting banks, reporting Supreme Court decisions, rulings of the Federal Reserve Board, etc
- 5 Attending to the details surrounding the bidding on Government contracts and matters of patent, copyright, pensions, claims, etc.

Some large banks maintain a Washington bureau for such work, while others do it through Washington firms that represent a large number of banks subscribing to their service

Check Books and Forms.

Banks everywhere furnish their customers with checks free of charge, and geneially print the customer's name on the stub gratis, although the cost runs high. A book of 300 checks will cost between three and four dollars. Many large banks have their own printing plant for small work, such as printing these names. A record is kept of all orders, together with the first and last number of the checks, for guidance in future orders

The stock room contains a large supply of forms, checks and records of various kinds. Deliveries are by requisition, and inventories are made from time to time, and stationery used is charged to the department receiving the same. A running inventory is kept in order that supplies may not run short.

Addressing Lists.

Many banks maintain up-to-date mailing lists for advertising purposes, stockholders' notices, statements, list of employees, and dividends, etc. There is also the mimeograph and typewriting department as distinguished from the secretarial work of the bank's stenographic force.

APPENDIX

THE NEGOTIABLE INSTRUMENTS LAW

(*Uniform in forty-six states*)

FORM AND INTERPRETATION

Section	1	Requirements in general
	2	When sum payable is certain
	3	When promise is unconditional
	4	Determinable future time, what constitutes
	5	Provisions which do not impair negotiability
	6	Matters not affecting validity, etc
	7	When payable on demand
	8	When payable to order
	9	When payable to bearer
	10	What terms sufficient
	11	Presumption as to date
	12	Ante-dated and post-dated
	13	When date may be inserted
	14	Filling blanks—rights of holder
	15	Incomplete instrument not delivered
	16	Necessity for delivery—presumption
	17	Construction where instrument is ambiguous
	18	Only person signing liable—trade name
	19	Signature by agent—authority—how shown
	20	Signature on behalf of principal
	21	Signature by procuration—effect of
	22	Indorsement by infant or corporation
	23	Forged signature inoperative—estoppel

§ 1 Requirements to which instrument must conform—An instrument to be negotiable must conform to the following requirements

- 1 It must be in writing and signed by the maker or drawer,
- 2 Must contain an unconditional promise or order to pay a sum certain in money,
- 3 Must be payable on demand, or at a fixed or determinable future time,
- 4 Must be payable to order, or to bearer, and

5 Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty

§ 2 When sum payable is a sum certain—The sum payable is a sum certain within the meaning of this act, although it is to be paid

- 1 With interest, or
- 2 By stated instalments, or
- 3 By stated instalments, with a provision that upon default in payment of any instalment or of interest the whole shall become due, or
- 4 With exchange, whether at a fixed rate or at the current rate, or
- 5 With costs of collection or an attorney's fee, in case payment shall not be made at maturity

§ 3 When promise is unconditional—An unqualified order or promise to pay is unconditional within the meaning of this act, though coupled with

1 An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount, or

2 A statement of the transaction which gives rise to the instrument

But an order or promise to pay out of a particular fund is not unconditional

§ 4 Determinable future time—What constitutes—An instrument is payable at a determinable future time, within the meaning of this act, which is expressed to be payable

- 1 At a fixed period after date or sight, or
- 2 On or before a fixed or determinable future time specified therein, or
- 3 On or at a fixed period after the occurrence of a specified event, which is certain to happen, though the time of happening be uncertain

An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect

§ 5. Provisions which do not impair negotiability—An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable. But the negotiable character of an instrument otherwise negotiable is not affected by a provision which.

1 Authorizes the sale of collateral securities in case the instrument be not paid at maturity, or

2 Authorizes a confession of judgment if the instrument be not paid at maturity, or

3 Waives the benefit of any law intended for the advantage or protection of the obligor, or

4 Gives the holder an election to require something to be done in lieu of payment of money

But nothing in this section shall validate any provision or stipulation otherwise illegal

§ 6 Matters which do not affect validity, etc., of instrument.—The validity and negotiable character of an instrument are not affected by the fact that

- 1 It is not dated, or
- 2 Does not specify the value given, or that any value has been given therefor, or
3. Does not specify the place where it is drawn or the place where it is payable, or
- 4 Bears a seal, or
- 5 Designates a particular kind of current money in which payment is to be made

But nothing in this section shall alter or repeal any statute requiring in certain cases the nature of the consideration to be stated in the instrument

§ 7 When payable on demand—An instrument is payable on demand

- 1 Where it is expressed to be payable on demand, or at sight, or on presentation, or

- 2 In which no time for payment is expressed

Where an instrument is issued, accepted or indorsed when overdue, it is, as regards the person so issuing, accepting or indorsing it, payable on demand

§ 8 When payable to order—The instrument is payable to order where it is drawn payable to the order of a specified person or to him or his order. It may be drawn payable to the order of

1. A payee who is not maker, drawer or drawee, or
2. The drawer or maker, or
- 3 The drawee, or
- 4 Two or more payees jointly, or
- 5 One or some of several payees, or
- 6 The holder of an office for the time being

Where the instrument is payable to order the payee must be named or otherwise indicated therein with reasonable certainty

§ 9 When payable to bearer—The instrument is payable to bearer

- 1 When it is expressed to be so payable, or
- 2 When it is payable to a person named therein or bearer, or
- 3 When it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable, or
- 4 When the name of the payee does not purport to be the name of any person, or

- 5 When the only or last indorsement is an indorsement in blank

§ 10. What terms sufficient.—The instrument need not follow the language of this act, but any terms are sufficient which clearly indicate an intention to conform to the requirements hereof

§ 11. Presumption as to date—Where the instrument or an acceptance or any indorsement thereon is dated, such date is deemed prima facie to be the true date of the making, drawing, acceptance or indorsement, as the case may be

§ 12 **Ante-dated and post-dated**—The instrument is not invalid for the reason only that it is ante-dated or post-dated, provided this is not done for an illegal or fraudulent purpose. The person to whom an instrument so dated is delivered acquires the title thereto as of the date of delivery.

§ 13. **When date may be inserted**—Where an instrument expressed to be payable at a fixed period after date is issued undated, or where the acceptance of an instrument payable at a fixed period after sight is undated, any holder may insert therein the true date of issue or acceptance, and the instrument shall be payable accordingly. The insertion of a wrong date does not avoid the instrument in the hands of a subsequent holder in due course, but as to him, the date so inserted is to be regarded as the true date.

§ 14 **Filling blanks—rights of holder**—Where the instrument is wanting in any material particular, the person in possession thereof has a prima facie authority to complete it by filling up the blanks therein. And a signature on a blank paper delivered by the person making the signature in order that the paper may be converted into a negotiable instrument operates as a prima facie authority to fill it up as such for any amount. In order, however, that any such instrument, when completed, may be enforced against any person who became a party thereto prior to its completion, it must be filled up strictly in accordance with the authority given and within a reasonable time. But if any such instrument, after completion, is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it as if it had been filled up strictly in accordance with the authority given and within a reasonable time.

§ 15 **Incomplete instrument not delivered**—Where an incomplete instrument has not been delivered it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder, as against any person whose signature was placed thereon before delivery.

§ 16 **Necessity for delivery—presumption of—when effectual—when presumed**—Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. As between immediate parties, and as regards a remote party other than a holder in due course, the delivery, in order to be effectual, must be made either by or under the authority of the party making, drawing, accepting or indorsing, as the case may be, and in such case the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument. But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed. And where the instrument is no longer in the possession of a party whose signature appears thereon,

a valid and intentional delivery by him is presumed until the contrary is proved

§ 17. Construction where instrument is ambiguous—Where the language of the instrument is ambiguous, or there are omissions therein, the following rules of construction apply

1 Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable, but if the words are ambiguous or uncertain, reference may be had to the figures to fix the amount,

2 Where the instrument provides for the payment of interest, without specifying the date from which interest is to run, the interest runs from the date of the instrument, and if the instrument is undated, from the issue thereof,

3 Where the instrument is not dated, it will be considered to be dated as of the time it was issued,

4 Where there is a conflict between the written and printed provisions of the instrument, the written provisions prevail,

5 Where the instrument is so ambiguous that there is doubt whether it is a bill or note, the holder may treat it as either at his election,

6 Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is to be deemed an indorser,

7 Where an instrument containing the words "I promise to pay" is signed by two or more persons, they are deemed to be jointly and severally liable thereon

§ 18 Only persons signing liable—trade or assumed name—No person is liable on the instrument whose signature does not appear thereon, except as herein otherwise expressly provided. But one who signs in a trade or assumed name will be liable to the same extent as if he had signed in his own name

§ 19 Signature by agent—authority—how shown—The signature of any party may be made by a duly authorized agent. No particular form of appointment is necessary for this purpose, and the authority of the agent may be established as in other cases of agency

§ 20. Signature on behalf of principal—personal liability—liability of person signing as agent, etc—Where the instrument contains or a person adds to his signature words indicating that he signs for or on behalf of a principal, or in a representative capacity, he is not liable on the instrument if he was duly authorized, but the mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability

§ 21. Signature by procuration—effect of—A signature by "procuration" operates as notice that the agent has but a limited authority to sign, and the principal is bound only in case the agent in so signing acted within the actual limits of his authority

§ 22 Indorsement by infant or corporation—effect of —The indorsement or assignment of the instrument by a corporation or by an infant passes the property therein, notwithstanding that from want of capacity the corporation or infant may incur no liability thereon

§ 23. Forged signature inoperative—estoppel —Where a signature is forged or made without the authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority.

CONSIDERATION

Section 24 Presumption of consideration

25 What constitutes value

26 Value given by prior holder

27 Lienor as holder for value

28 Failure of consideration

29 Accommodation party—definition—liability

§ 24 Presumption of consideration —Every negotiable instrument is deemed *prima facie* to have been issued for a valuable consideration, and every person whose signature appears thereon to have become a party thereto for value

§ 25. What constitutes value—antecedent debt —Value is any consideration sufficient to support a simple contract. An antecedent or preexisting debt constitutes value, and is deemed such whether the instrument is payable on demand or at a future time

§ 26 Value given by prior holder —Where value has at any time been given for the instrument, the holder is deemed a holder for value in respect to all parties who become such prior to that time

§ 27 Lienor a holder for value—to what extent —Where the holder has a lien on the instrument, arising either from contract or by implication of law, he is deemed a holder for value, to the extent of his lien

§ 28 Failure of consideration—partial failure —Absence or failure of consideration is matter of defense as against any person not a holder in due course, and partial failure of consideration is a defense *pro tanto*, whether the failure is an ascertained and liquidated amount or otherwise

§ 29. Accommodation party—definition—liability —An accommodation party is one who has signed the instrument as maker, drawer, acceptor or indorser, without receiving value therefor, and for the purpose of lending his name to some other person. Such a person is liable on the instrument to a holder for value, notwithstanding such holder at the time of taking the instrument knew him to be only an accommodation party

NEGOTIATION

- Section 30 What constitutes negotiation
 31 How indorsement made
 32 Indorsement must be of entire instrument
 33 Kinds of indorsement
 34 Special indorsement—indorsement in blank
 35 Converting blank indorsement into special indorsement
 36 When indorsement restrictive
 37 Effect of restrictive indorsement—rights of indorsee
 38 Qualified indorsement
 39 Conditional indorsement
 40 Indorsement of instrument payable to bearer
 41 Indorsement where payable to two or more persons
 42 Instrument payable to cashier—To fiscal officer of corporation
 43 Mistake in name of payee—form of indorsement
 44 Indorsement in representative capacity
 45 Presumption as to time of
 46 Presumption as to place of
 47 Continuation of negotiable character
 48 Striking out indorsement
 49 Transfer without indorsement—effect of
 50 When prior party may negotiate instrument

§ 30. What constitutes negotiation.—An instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof. If payable to bearer it is negotiated by delivery, if payable to order it is negotiated by the indorsement of the holder completed by delivery.

§ 31 How indorsement made.—The indorsement must be written on the instrument itself or upon a paper attached thereto. The signature of the indorser, without additional words, is a sufficient indorsement.

§ 32 Indorsement must be of entire instrument.—The indorsement must be an indorsement of the entire instrument. An indorsement which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more indorsees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue.

§ 33 Kinds of indorsement.—An indorsement may be either special or in blank, and it may also be either restrictive or qualified, or conditional.

§ 34 Special indorsement—indorsement in blank.—A special indorsement specifies the person to whom, or to whose order the instrument is to be payable, and the indorsement of such indorsee is necessary to the

further negotiation of the instrument. An indorsement in blank specifies no indorsee, and an instrument so indorsed is payable to bearer, and may be negotiated by delivery.

§ 35 **Converting blank indorsement into special indorsement**—The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement.

§ 36 **When indorsement restrictive**.—An indorsement is restrictive, which either

- 1 Prohibits the further negotiation of the instrument; or
- 2 Constitutes the indorsee the agent of the indorser, or
- 3 Vests the title in the indorsee in trust for or to the use of some other person.

But the mere absence of words implying power to negotiate does not make an indorsement restrictive.

§ 37 **Effect of restrictive indorsement—rights of indorsee**.—A restrictive indorsement confers upon the indorsee the right

- 1 To receive payment of the instrument,
- 2 To bring any action thereon that the indorser could bring,
- 3 To transfer his rights as such indorsee, where the form of the indorsement authorizes him to do so.

But all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement.

§ 38. **Qualified indorsement**—A qualified indorsement constitutes the indorser a mere assignor of the title to the instrument. It may be made by adding to the indorser's signature the words "without recourse" or any words of similar import. Such an indorsement does not impair the negotiable character of the instrument.

§ 39. **Conditional indorsement**—Where an indorsement is conditional, a party required to pay the instrument may disregard the condition and make payment to the indorsee or his transferee, whether the condition has been fulfilled or not. But any person to whom an instrument so indorsed is negotiated will hold the same, or the proceeds thereof, subject to the rights of the person indorsing conditionally.

§ 40. **Indorsement of instrument payable to bearer**.—Where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery, but the person indorsing specially is liable as indorser to only such holders as take title through his indorsement.

§ 41 **Indorsement where payable to two or more persons**—Where an instrument is payable to the order of two or more payees or indorsees who are not partners, all must indorse, unless the one indorsing has authority to indorse for the others.

§ 42. **Instrument payable to cashier—to fiscal officer of corporation**—Where an instrument is drawn or indorsed to a person as "cashier"

or other fiscal officer of a bank or corporation, it is deemed *prima facie* to be payable to the bank or corporation of which he is such officer, and may be negotiated by either the indorsement of the bank or corporation, or the indorsement of the officer

§ 43. Mistake in name of payee—form of indorsement—Where the name of a payee or indorsee is wrongly designated or misspelled, he may indorse the instrument as therein described, adding, if he think fit, his proper signature

§ 44 Indorsement in representative capacity—Where any person is under obligation to indorse in a representative capacity, he may indorse in such terms as to negative personal liability

§ 45 Presumption as to time of.—Except where an indorsement bears date after the maturity of the instrument every negotiation is deemed *prima facie* to have been effected before the instrument was overdue

§ 46 Presumption as to place of —Except where the contrary appears, every indorsement is presumed *prima facie* to have been made at the place where the instrument is dated

§ 47. Continuation of negotiable character —An instrument negotiable in its origin continues to be negotiable until it has been restitively indorsed or discharged by payment or otherwise

§ 48 Striking out indorsement.—The holder may at any time strike out any indorsement which is not necessary to his title The indorser whose indorsement is struck out, and all indorsers subsequent to him, are thereby relieved from liability on the instrument

§ 49 Transfer without indorsement—Effect of —Where the holder of an instrument payable to his order transfers it for value without indorsing it, the transfer vests in the transferee such title as the transferrer had therein, and the transferee acquires, in addition, the right to have the indorsement of the transferrer But for the purpose of determining whether the transferee is a holder in due course, the negotiation takes effect as of the time when the indorsement is actually made

§ 50. When prior party may negotiate instrument—Where an instrument is negotiated back to a prior party, such party may, subject to the provisions of this act, reissue and further negotiate the same But he is not entitled to enforce payment thereof against any intervening party to whom he was personally liable

RIGHTS OF HOLDER

- Section 51 Right of holder to sue—payment
- 52 What constitutes a holder in due course
- 53 Instrument payable on demand—negotiation of—unreasonable time
- 54 Notice before full amount paid
- 55 When title defective

- 56 What constitutes notice of defect
- 57 Rights of holder in due course
- 58 When subject to original defenses
- 59 Presumption—Burden of proof

§ 51 **Right of holder to sue—Payment.**—The holder of a negotiable instrument may sue thereon in his own name, and payment to him in due course discharges the instrument

§ 52 **What constitutes a holder in due course**—A holder in due course is a holder who has taken the instrument under the following conditions

- 1 That it is complete and regular upon its face,
- 2 That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact,
- 3 That he took it in good faith and for value,
- 4 That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it

§ 53 **Instrument payable on demand—negotiation at unreasonable time**—Where an instrument payable on demand is negotiated an unreasonable length of time after its issue, the holder is not deemed a holder in due course

§ 54 **Notice before full amount paid**—Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him

§ 55 **When title defective**—The title of a person who negotiates an instrument is defective within the meaning of this act when he obtains the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to a fraud

§ 56 **What constitutes notice of defect**—To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith

§ 57. **Rights of holder in due course**—A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon

§ 58 **When subject to original defenses**—In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were non-negotiable. But a holder who derives his title through a holder in due course, and who is not himself a party

to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect of all parties prior to the latter

§ 59 **Presumption—burden of proof—exception**—Every holder is deemed *prima facie* to be a holder in due course, but when it is shown that the title of any person who has negotiated the instrument was defective, the burden is on the holder to prove that he or some person under whom he claims acquired the title as a holder in due course. But the last-mentioned rule does not apply in favor of a party who became bound on the instrument prior to the acquisition of such defective title

LIABILITY OF PARTIES

- Section 60 Liability of maker
- 61 Liability of drawer
- 62 Liability of acceptor.
- 63 When person deemed indorser
- 64 Liability of irregular indorser
- 65 Warranty where negotiation by delivery or qualified indorsement
- 66 Liability of general indorser
- 67 Liability of indorser where paper negotiable by delivery
- 68 Order in which indorsers are liable
- 69 Liability of agent or broker

§ 60 **Liability of maker**—The maker of a negotiable instrument by making it engages that he will pay it according to its tenor, and admits the existence of the payee and his then capacity to indorse

§ 61 **Liability of drawer**—The drawer by drawing the instrument admits the existence of the payee and his then capacity to indorse, and engages that on due presentment the instrument will be accepted or paid, or both, according to its tenor, and that if it be dishonored and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it. But the drawer may insert in the instrument an express stipulation negating or limiting his own liability to the holder

§ 62 **Liability of acceptor**—The acceptor by accepting the instrument engages that he will pay it according to the tenor of his acceptance, and admits

1 The existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument, and

2 The existence of the payee and his then capacity to indorse

§ 63. **When person deemed indorser.**—A person placing his signature upon an instrument otherwise than as maker, drawer or acceptor is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity

§ 64 **Liability of irregular indorser.**—Where a person, not otherwise

a party to an instrument, places thereon his signature in blank before delivery, he is liable as indorser in accordance with the following rules

1 If the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties

2 If the instrument is payable to the order of the maker or drawer, or is payable to bearer, he is liable to all parties subsequent to the maker or drawer

3 If he signs for the accommodation of the payee, he is liable to all parties subsequent to the payee

§ 65 Warranty where negotiation by delivery or qualified indorsement—Every person negotiating an instrument by delivery or by a qualified indorsement, warrants

1 That the instrument is genuine and in all respects what it purports to be,

2 That he has a good title to it,

3 That all prior parties had capacity to contract,

4 That he has no knowledge of any fact which would impair the validity of the instrument or render it valueless

But when the negotiation is by delivery only, the warranty extends in favor of no holder other than the immediate transferee. The provisions of subdivision three of this section do not apply to persons negotiating public or corporate securities, other than bills and notes

§ 66 Liability of general indorser—Every indorser who indorses without qualification, warrants to all subsequent holders in due course

1 The matters and things mentioned in subdivisions one, two and three of the next preceding section, and

2 That the instrument is at the time of his indorsement valid and subsisting

And, in addition, he engages that on due presentment it shall be accepted or paid, or both, as the case may be, according to its tenor, and that if it be dishonored, and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it

§ 67 Liability of indorser where paper negotiable by delivery—Where a person places his indorsement on an instrument negotiable by delivery he incurs all the liabilities of an indorser

§ 68. Order in which indorsers are liable—As respects one another indorsers are liable *prima facie* in the order in which they indorse, but evidence is admissible to show that as between or among themselves they have agreed otherwise. Joint payees or joint indorsee who indorse are deemed to indorse jointly and severally

§ 69 Liability of agent or broker—Where a broker or other agent negotiates an instrument without indorsement, he incurs all the liabilities prescribed by section sixty-five of this act, unless he discloses the name of his principal, and the fact that he is acting only as agent.

PRESENTMENT FOR PAYMENT

- Section 70 When presentment necessary—effect of failure to present
 71 Where not payable on demand—where payable on demand
 72 What constitutes a sufficient presentment
 73 Place of presentment
 74 Instrument must be exhibited
 75 Presentment where instrument payable at bank
 76 Where person primarily liable is dead
 77 Presentment to persons liable as partners
 78 Presentment to joint debtors
 79 When presentment not required to charge the drawer
 80 When presentment not required to charge the indorser.
 81 When delay in making presentment is excused
 82 When presentment may be dispensed with
 83 When instrument dishonored by non-payment
 84 Right of recourse to parties secondarily liable
 85 Time of maturity.
 86 How time computed
 87 Instrument payable at bank—effect of
 88 What constitutes payment in due course

§ 70 When presentment necessary—effect of failure to present—
 Presentment for payment is not necessary in order to charge the person primarily liable on the instrument, but if the instrument is, by its terms, payable at a special place, and he is able and willing to pay it there at maturity, such ability and willingness are equivalent to a tender of payment upon his part. But except as herein otherwise provided, presentment for payment is necessary in order to charge the drawer and indorsers.

§ 71 Where not payable on demand—where payable on demand—
 Where the instrument is not payable on demand, presentment must be made on the day it falls due. Where it is payable on demand, presentment must be made within a reasonable time after its issue, except that in the case of a bill of exchange, presentment for payment will be sufficient if made within a reasonable time after the last negotiation thereof.

§ 72 What constitutes a sufficient presentment—Presentment for payment, to be sufficient, must be made

1 By the holder, or by some person authorized to receive payment on his behalf;

2 At a reasonable hour on a business day,

3 At a proper place as herein defined,

4 To the person primarily liable on the instrument, or if he is absent or inaccessible, to any person found at the place where the presentment is made,

§ 73 Place of presentment — Presentment for payment is made at the proper place

1 Where a place of payment is specified in the instrument and it is there presented,

2 Where no place of payment is specified, but the address of the person to make payment is given in the instrument and it is there presented,

3 Where no place of payment is specified and no address is given and the instrument is presented at the usual place of business or residence of the person to make payment,

4 In any other case if presented to the person to make payment wherever he can be found, or if presented at his last known place of business or residence

§ 74 Instrument must be exhibited — The instrument must be exhibited to the person from whom payment is demanded, and when it is paid must be delivered up to the party paying it

§ 75. Presentment where instrument payable at bank — Where the instrument is payable at a bank, presentment for payment must be made during banking hours, unless the person to make payment has no funds there to meet it at any time during the day, in which case presentment at any hour before the bank is closed on that day is sufficient

§ 76 Where person primarily liable is dead — Where the person primarily liable on the instrument is dead, and no place of payment is specified, presentment for payment must be made to his personal representative if such there be, and if, with the exercise of reasonable diligence, he can be found

§ 77. Presentment to persons liable as partners — Where the persons primarily liable on the instrument are liable as partners, and no place of payment is specified, presentment for payment may be made to any one of them, even though there has been a dissolution of the firm

§ 78 Presentment to joint debtors — Where there are several persons, not partners, primarily liable on the instrument, and no place of payment is specified, presentment must be made to them all

§ 79 When presentment not required to charge the drawer — Presentment for payment is not required in order to charge the drawer where he has no right to expect or require that the drawee or acceptor will pay the instrument

§ 80 When presentment not required to charge the indorser — Presentment for payment is not required in order to charge an indorser where the instrument was made or accepted for his accommodation, and he has no reason to expect that the instrument will be paid if presented

§ 81. When delay in making presentment is excused — Delay in making presentment for payment is excused when the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, presentment must be made with reasonable diligence,

§ 82 When presentment may be dispensed with—Presentment for payment is dispensed with

1 Where after the exercise of reasonable diligence presentment as required by this act cannot be made,

2 Where the drawee is a fictitious person,

3 By waiver of presentment express or implied

§ 83 When instrument dishonored by non-payment—The instrument is dishonored by non-payment when

1 It is duly presented for payment and payment is refused or cannot be obtained, or

2 Presentment is excused and the instrument is overdue and unpaid

§ 84 Right of recourse to parties secondarily liable—Subject to the provisions of this act, when the instrument is dishonored by non-payment, an immediate right of recourse to all parties secondarily liable thereon, accrues to the holder

§ 85. Time of maturity.—Every negotiable instrument is payable at the time fixed therein without grace. When the day of maturity falls upon Sunday, or a holiday, the instrument is payable on the next succeeding business day. Instruments falling due or becoming payable on Saturday are to be presented for payment on the next succeeding business day, except that instruments payable on demand may, at the option of the holder, be presented for payment before twelve o'clock noon on Saturday when that entire day is not a holiday

§ 86 How time computed—Where the instrument is payable at a fixed period after date, after sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run, and by including the date of payment

§ 87 Instrument payable at bank—effect of—Where the instrument is made payable at a bank it is equivalent to an order to the bank to pay the same for the account of the principal debtor thereon

§ 88 What constitutes payment in due course—Payment is made in due course when it is made at or after the maturity of the instrument to the holder thereof in good faith and without notice that his title is defective

NOTICE OF DISHONOR

Section 89 To whom notice of dishonor must be given

90 By whom given

91 Notice given by agent

92 Effect of notice given on behalf of holder

93 Effect where notice is given by party entitled thereto

94 When agent may give notice

95 When notice sufficient

96 Form of notice

97 To whom notice may be given

- 98 Notice where party is dead
- 99 Notice to partners
- 100 Notice to other joint parties
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- 102 Time within which notice to be given
- 103 Where parties reside in same place
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- 105 Mis carriage in mails—notice deemed to have been given
- 106 Deposit in post-office—what constitutes
- 107 Notice to antecedent parties—time of
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- 109 Waiver of notice
- 110 Parties affected by waiver
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- 112 When notice dispensed with
- 113 When delay in giving notice is excused
- 114 When notice need not be given to drawer
- 115 When notice need not be given to indorser
- 116 Where notice of non-acceptance has been given
- 117 Omission to give notice of non-acceptance—subsequent holder
- 118 Protest authorized in all cases of dishonor—when required

§ 89. To whom notice of dishonor must be given.—Except as herein otherwise provided, when a negotiable instrument has been dishonored by non-acceptance or non-payment, notice of dishonor must be given to the drawer and to each indorser, and any drawer or indorser to whom such notice is not given is discharged.

§ 90. By whom given.—The notice may be given by or on behalf of the holder, or by or on behalf of any party to the instrument who might be compelled to pay it to the holder, and who, upon taking it up, would have a right to reimbursement from the party to whom the notice is given.

§ 91. Notice given by agent.—Notice of dishonor may be given by an agent either in his own name or in the name of any party entitled to give notice, whether that party be his principal or not.

§ 92. Effect of notice given on behalf of holder.—Where notice is given by or on behalf of the holder, it enures for the benefit of all subsequent holders and all prior parties who have a right of recourse against the party to whom it is given.

§ 93. Effect where notice is given by party entitled thereto.—Where notice is given by or on behalf of a party entitled to give notice, it enures for the benefit of the holder and all parties subsequent to the party to whom notice is given.

§ 94. When agent may give notice.—Where the instrument has been dishonored in the hands of an agent, he may either himself give notice

to the parties liable thereon, or he may give notice to his principal. If he give notice to his principal, he must do so within the same time as if he were the holder, and the principal, upon the receipt of such notice, has himself the same time for giving notice as if the agent had been an independent holder.

§ 95. *When notice sufficient*—A written notice need not be signed, and an insufficient written notice may be supplemented and validated by verbal communication. A misdescription of the instrument does not vitiate the notice unless the party to whom the notice is given is in fact misled thereby.

§ 96. *Form of notice*—The notice may be in writing or merely oral, and may be given in any terms which sufficiently identify the instrument, and indicate that it has been dishonored by non-acceptance or non-payment. It may in all cases be given by delivering it personally or through the mails.

§ 97. *To whom notice may be given*—Notice of dishonor may be given either to the party himself or to his agent in that behalf.

§ 98. *Notice where party is dead*—When any party is dead, and his death is known to the party giving notice, the notice must be given to a personal representative, if there be one, and if with reasonable diligence he can be found. If there be no personal representative, notice may be sent to the last residence or last place of business of the deceased.

§ 99. *Notice to partners*—Where the parties to be notified are partners, notice to any one partner is notice to the firm, even though there has been a dissolution.

§ 100. *Notice to other joint parties*—Notice to joint parties who are not partners must be given to each of them, unless one of them has authority to receive such notice for the others.

§ 101. *Notice to bankrupt*—Where a party has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, notice may be given either to the party himself or to his trustee or assignee.

§ 102. *Time within which notice to be given*—Notice may be given as soon as the instrument is dishonored, and unless delay is excused as hereinafter provided, must be given within the times fixed by this act.

§ 103. *Where parties reside in same place*—Where the person giving and the person to receive notice reside in the same place, notice must be given within the following times:

1. If given at the place of business of the person to receive notice, it must be given before the close of business hours on the day following,

2. If given at his residence, it must be given before the usual hours of rest on the day following,

3. If sent by mail, it must be deposited in the post-office in time to reach him in usual course on the day following.

§ 104 Where parties reside in different places.—Where the person giving and the person to receive notice reside in different places, the notice must be given within the following times

1 If sent by mail, it must be deposited in the post-office in time to go by mail the day following the day of dishonor, or if there be no mail at a convenient hour on that day, by the next mail thereafter

2 If given otherwise than through the post-office, then within the time that notice would have been received in due course of mail, if it had been deposited in the post-office within the time specified in the last subdivision

§ 105 Mis carriage in mails—notice deemed to have been given —Where notice of dishonor is duly addressed and deposited in the post-office, the sender is deemed to have given due notice, notwithstanding any miscarriage in the mails

§ 106 Deposit in post-office—what constitutes —Notice is deemed to have been deposited in the post-office when deposited in any branch post-office or in any letter-box under the control of the post-office department

§ 107. Notice to antecedent parties—time of —Where a party receives notice of dishonor, he has, after the receipt of such notice, the same time for giving notice to antecedent parties that the holder has after the dishonor

§ 108 Where notice must be sent—Where a party has added an address to his signature, notice of dishonor must be sent to that address, but if he has not given such address, then the notice must be sent as follows

1 Either to the post-office nearest to his place of residence, or to the post-office where he is accustomed to receive his letters, or

2 If he live in one place, and have his place of business in another, notice may be sent to either place, or

3 If he is sojourning in another place, notice may be sent to the place where he is sojourning

But where the notice is actually received by the party within the time specified in this act, it will be sufficient, though not sent in accordance with the requirements of this section

§ 109. Waiver of notice —Notice of dishonor may be waived, either before the time of giving notice has arrived, or after the omission to give due notice, and the waiver may be expressed or implied

§ 110. Parties affected by waiver —Where the waiver is embodied in the instrument itself, it is binding upon all parties, but where it is written above the signature of an indorser, it binds him only

§ 111. Waiver of protest —A waiver of protest, whether in the case of a foreign bill of exchange or other negotiable instrument, is deemed to be a waiver not only of a formal protest, but also of presentment and notice of dishonor.

§ 112 When notice is dispensed with—Notice of dishonor is dispensed with when, after the exercise of reasonable diligence, it cannot be given to or does not reach the parties sought to be charged

§ 113 When delay in giving notice is excused—Delay in giving notice of dishonor is excused when the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. When the cause of delay ceases to operate, notice must be given with reasonable diligence

§ 114 When notice need not be given to drawer—Notice of dishonor is not required to be given to the drawer in either of the following cases

- 1 Where the drawer and drawee are the same person,
- 2 Where the drawee is a fictitious person or a person not having capacity to contract,
- 3 Where the drawer is the person to whom the instrument is presented for payment,
- 4 Where the drawer has no right to expect or require that the drawee or acceptor will honor the instrument,
- 5 Where the drawer has countermanded payment

§ 115. When notice need not be given to indorser—Notice of dishonor is not required to be given to an indorser in either of the following cases

- 1 Where the drawee is a fictitious person or a person not having capacity to contract, and the indorser was aware of the fact at the time he indorsed the instrument,
- 2 Where the indorser is the person to whom the instrument is presented for payment,
- 3 Where the instrument was made or accepted for his accommodation

§ 116 Where notice of non-acceptance has been given—Where due notice of dishonor by non-acceptance has been given, notice of a subsequent dishonor by non-payment is not necessary, unless in the meantime the instrument has been accepted

§ 117 Omission to give notice of non-acceptance—subsequent holder—An omission to give notice of dishonor by non-acceptance does not prejudice the rights of a holder in due course subsequent to the omission

§ 118 Protest authorized in all cases of dishonor—when required—Where any negotiable instrument has been dishonored it may be protested for non-acceptance or non-payment, as the case may be, but protest is not required, except in the case of foreign bills of exchange

DISCHARGE OF NEGOTIABLE INSTRUMENTS

Section 119 How instrument discharged

120 When person secondarily liable is discharged

121 Payment by person secondarily liable—effect of

122 Renunciation by holder

- 123 Unintentional cancellation
- 124 Alteration of instrument—effect of
- 125 What constitutes a material alteration

§ 119. How instrument discharged —A negotiable instrument is discharged

- 1 By payment in due course by or on behalf of the principal debtor,
- 2 By payment in due course by the party accommodated, where the instrument is made or accepted for accommodation,
- 3 By the intentional cancellation thereof by the holder,
- 4 By any other act which will discharge a simple contract for the payment of money,
- 5 When the principal debtor becomes the holder of the instrument at or after maturity in his own right

§ 120. When person secondarily liable is discharged —A person secondarily liable on the instrument is discharged

- 1 By any act which discharges the instrument,
- 2 By the intentional cancellation of his signature by the holder,
- 3 By the discharge of a prior party,
- 4 By a valid tender of payment made by a prior party,
- 5 By a release of the principal debtor, unless the holder's right of recourse against the party secondarily liable is expressly reserved,
- 6 By any agreement binding upon the holder to extend the time of payment or to postpone the holder's right to enforce the instrument, unless made with the assent of the party secondarily liable, or unless the right of recourse against such party is expressly reserved

§ 121 Payment by party secondarily liable—effect of —Where the instrument is paid by a party secondarily liable thereon, it is not discharge, but the party so paying it is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument, except

- 1 Where it is payable to the order of a third person, and has been paid by the drawer, and
- 2 Where it was made or accepted for accommodation, and has been paid by the party accommodated

§ 122. Renunciation by holder —The holder may expressly renounce his rights against any party to the instrument, before, at or after its maturity. An absolute and unconditional renunciation of his rights against the principal debtor made at or after the maturity of the instrument discharges the instrument. But a renunciation does not affect the rights of a holder in due course without notice. A renunciation must be in writing, unless the instrument is delivered up to the person primarily liable thereon.

§ 123 Unintentional cancellation—burden of proof —A cancellation made unintentionally, or under a mistake, or without authority of the holder, is inoperative, but where an instrument or any signature thereon

appears to have been canceled the burden of proof lies on the party who alleges that the cancellation was made unintentionally, or under a mistake or without authority

§ 124 Alteration of instrument—effect of—Where a negotiable instrument is materially altered without the assent of all parties liable thereon, it is avoided, except as against a party who has himself made, authorized or assented to the alteration and subsequent indorsers. But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor.

§ 125 What constitutes a material alteration—Any alteration which changes

- 1 The date,
- 2 The sum payable, either for principal or interest,
- 3 The time or place of payment,
- 4 The number or the relations of the parties,
- 5 The medium or currency in which payment is to be made,

Or which adds a place of payment where no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect, is a material alteration.

BILLS OF EXCHANGE, FORM AND INTERPRETATION

Section 126 Bill of exchange defined

127 Bill not an assignment of funds in hands of drawee

128 Bill addressed to more than one drawee

129 Inland and foreign bills of exchange

130 When bill may be treated as promissory note

131 Referee in case of need

§ 126 Bill of exchange defined—A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer.

§ 127. Bill not an assignment of funds in hands of drawee—A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same.

§ 128 Bill addressed to more than one drawee—A bill may be addressed to two or more drawees jointly, whether they are partners or not, but not to two or more drawees in the alternative or in succession.

§ 129 Inland and foreign bills of exchange—An inland bill of exchange is a bill which is, or on its face purports to be, both drawn and payable within this State. Any other bill is a foreign bill. Unless the contrary appears on the face of the bill, the holder may treat it as an inland bill.

§ 130. When bill may be treated as promissory note — Where in a bill the drawer and drawee are the same person, or where the drawee is a fictitious person, or a person not having capacity to contract, the holder may treat the instrument, at his option, either as a bill of exchange or a promissory note

§ 131. Referee in case of need — The drawer of a bill and any indorser may insert thereon the name of a person to whom the holder may resort in case of need, that is to say, in case the bill is dishonored by non-acceptance or non-payment. Such person is called the referee in case of need. It is in the option of the holder to resort to the referee in case of need or not as he may see fit

ACCEPTANCE OF BILLS OF EXCHANGE

- Section 132 Acceptance—how made—form of
- 133 Holder entitled to acceptance on face of bill
 - 134 Acceptance by separate instrument
 - 135 Promise to accept—when equivalent to acceptance
 - 136 Time allowed drawee to accept
 - 137 Liability of drawee retaining or destroying bill
 - 138 Where bill incomplete, etc
 - 139 Kinds of acceptances
 - 140 Acceptance to pay at particular place
 - 141 Qualified acceptance
 - 142 Rights of parties as to qualified acceptance

§ 132. Acceptance—how made—form of — The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee. It must not express that the drawee will perform his promise by any other means than the payment of money.

§ 133. Holder entitled to acceptance on face of bill. — The holder of a bill presenting the same for acceptance may require that the acceptance be written on the bill and, if such request is refused, may treat the bill as dishonored.

§ 134. Acceptance by separate instrument — Where an acceptance is written on a paper other than the bill itself, it does not bind the acceptor except in favor of a person to whom it is shown and who, on the faith thereof, receives the bill for value.

§ 135. Promise to accept—when equivalent to acceptance — An unconditional promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person who, upon the faith thereof, receives the bill for value.

§ 136. Time allowed drawee to accept — The drawee is allowed twenty-four hours after presentment in which to decide whether or not

he will accept the bill, but the acceptance, if given, dates as of the day of presentation

§ 137 Liability of drawee retaining or destroying bill—Where a drawee to whom a bill is delivered for acceptance destroys the same, or refuses within twenty-four hours after such delivery, or within such other period as the holder may allow, to return the bill accepted or non-accepted to the holder, he will be deemed to have accepted the same

§ 138 Where bill incomplete or has been dishonored—A bill may be accepted before it has been signed by the drawer, or while otherwise incomplete, or when it is overdue, or after it has been dishonored by a previous refusal to accept, or by non-payment. But when a bill payable after sight is dishonored by non-acceptance and the drawee subsequently accepts it, the holder, in the absence of any different agreement, is entitled to have the bill accepted as of the date of the first presentment

§ 139 Kinds of acceptances—An acceptance is either general or qualified. A general acceptance assents without qualification to the order of the drawer. A qualified acceptance in express terms varies the effect of the bill as drawn

§ 140 Acceptance to pay at particular place—An acceptance to pay at a particular place is a general acceptance, unless it expressly states that the bill is to be paid there only and not elsewhere

§ 141 Qualified acceptance—An acceptance is qualified, which is

1 Conditional, that is to say, which makes payment by the acceptor dependent on the fulfillment of a condition therein stated,

2 Partial, that is to say, an acceptance to pay part only of the amount for which the bill is drawn,

3 Local, that is to say, an acceptance to pay only at a particular place,

4 Qualified as to time,

5 The acceptance of some one or more of the drawees, but not of all

§ 142 Rights of parties as to qualified acceptance—The holder may refuse to take a qualified acceptance, and if he does not obtain an unqualified acceptance, he may treat the bill as dishonored by non-acceptance. Where a qualified acceptance is taken the drawer and indorsers are discharged from liability on the bill, unless they have expressly or impliedly authorized the holder to take a qualified acceptance, or subsequently assent thereto. When the drawer or an indorser receives notice of a qualified acceptance he must, within a reasonable time, express his dissent to the holder, or he will be deemed to have assented thereto

PRESENTMENT FOR ACCEPTANCE

Section 143 When presentment for acceptance must be made

144 When failure to present releases drawer and indorser.

145 Requirements as to presentment

146 On what days presentment may be made.

147. Delay caused by previous presentment

- 148 When presentment is excused
- 149 When dishonored by non-acceptance
- 150 Duty of holder where bill not accepted
- 151 Rights of holder where bill not accepted

§ 143 When presentment for acceptance must be made — Presentment for acceptance must be made

1 Where the bill is payable after sight, or in any other case, where presentment for acceptance is necessary in order to fix the maturity of the instrument, or

2 Where the bill expressly stipulates that it shall be presented for acceptance, or

3 Where the bill is drawn payable elsewhere than at the residence or place of business of the drawee

In no other case is presentment for acceptance necessary in order to render any party to the bill liable

§ 144 When failure to present releases drawer and indorser — Except as herein otherwise provided, the holder of a bill which is required by the next preceding section to be presented for acceptance must either present it for acceptance or negotiate it within a reasonable time. If he fails to do so, the drawer and all indorsers are discharged

§ 145 Requirements as to presentment — Presentment for acceptance must be made by or on behalf of the holder at a reasonable hour, on a business day, and before the bill is overdue, to the drawee or some person authorized to accept or refuse acceptance on his behalf, and

1 Where a bill is addressed to two or more drawees who are not partners, presentment must be made to them all, unless one has authority to accept or refuse acceptance for all, in which case presentment may be made to him only,

2 Where the drawee is dead, presentment may be made to his personal representative,

3 Where the drawee has been adjudged a bankrupt or an insolvent or has made an assignment for the benefit of creditors, presentment may be made to him or to his trustee or assignee

§ 146. On what days presentment may be made — A bill may be presented for acceptance on any day on which negotiable instruments may be presented for payment under the provisions of sections seventy-two and eighty-five of this act. When Saturday is not otherwise a holiday, presentment for acceptance may be made before twelve o'clock noon on that day

§ 147 Delay caused by previous presentment — Where the holder of a bill drawn payable elsewhere than at the place of business or the residence of the drawee has not time with the exercise of reasonable diligence to present the bill for acceptance before presenting it for payment on the day that it falls due, the delay caused by presenting the bill for acceptance

before presenting it for payment is excused and does not discharge the drawers and indorsers

§ 148 When presentment is excused —Presentment for acceptance is excused and a bill may be treated as dishonored by non-acceptance in either of the following cases

1 Where the drawee is dead, or has absconded, or is a fictitious person or a person not having capacity to contract by bill,

2 Where, after the exercise of reasonable diligence, presentment cannot be made,

3 Where, although presentment has been irregular, acceptance has been refused on some other ground

§ 149 When dishonored by non-acceptance —A bill is dishonored by non-acceptance

1 When it is duly presented for acceptance, and such an acceptance as is prescribed by this act is refused or cannot be obtained, or

2 When presentment for acceptance is excused and the bill is not accepted

§ 150 Duty of holder where bill not accepted —Where a bill is duly presented for acceptance and is not accepted within the prescribed time, the person presenting it must treat the bill as dishonored by non-acceptance or he loses the right of recourse against the drawer and indorsers

§ 151. Rights of holder where bill not accepted —When a bill is dishonored by non-acceptance, an immediate right of recourse against the drawers and indorsers accrues to the holder, and no presentment for payment is necessary

PROTEST

Section 152 In what cases protest necessary

153 How protest made

154 By whom protest made

155 On what day to be made

156 Where to be made

157 Protest both for non-acceptance and non-payment

158 Protest before maturity where acceptor insolvent

159 When protest dispensed with

160 Where bill lost, destroyed or wrongly detained

§ 152. In what cases protest necessary —Where a foreign bill appearing on its face to be such is dishonored by non-acceptance, it must be duly protested for non-acceptance, and where such a bill which has not previously been dishonored by non-acceptance is dishonored by non-payment, it must be duly protested for non-payment. If it is not so protested, the drawer and indorsers are discharged. Where a bill does not appear on its face to be a foreign bill, protest thereof in case of dishonor is unnecessary

§ 153. How protest made.—The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify

1. The time and place of presentment,
2. The fact that presentment was made and the manner thereof,
3. The cause or reason for protesting the bill,
4. The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found

§ 154. By whom protest made.—Protest may be made by

1. A notary public, or
2. By any respectable resident of the place where the bill is dishonored, in the presence of two or more credible witnesses

§ 155. On what day to be made.—When a bill is protested, such protest must be made on the day of its dishonor, unless delay is excused as herein provided. When a bill has been duly noted, the protest may be subsequently extended as of the date of the noting

§ 156. Where to be made.—A bill must be protested at the place where it is dishonored, except that when a bill drawn payable at the place of business or residence of some person other than the drawee, has been dishonored by non-acceptance, it must be protested for non-payment at the place where it is expressed to be payable, and no further presentment for payment to, or demand on, the drawee is necessary

§ 157. Protest both for non-acceptance and non-payment.—A bill which has been protested for non-acceptance may be subsequently protested for non-payment

§ 158. Protest before maturity where acceptor insolvent.—Where the acceptor has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, before the bill matures, the holder may cause the bill to be protested for better security against the drawer and indorsers

§ 159. When protest dispensed with.—Protest is dispensed with by any circumstances which would dispense with notice of dishonor. Delay in noting or protesting is excused when delay is caused by circumstances beyond the control of the holder and not imputable to his default, misconduct, or negligence. When the cause of delay ceases to operate, the bill must be noted or protested with reasonable diligence

§ 160. Where bill is lost, or destroyed, or wrongly detained.—Where a bill is lost or destroyed or is wrongly detained from the person entitled to hold it, protest may be made on a copy or written particulars thereof

ACCEPTANCE FOR HONOR

Section 161. When bill may be accepted for honor

162. How acceptance for honor made

163. When deemed to be an acceptance for honor of the drawer

164. Liability of acceptor for honor

- 165 Agreement of acceptor for honor
- 166 Maturity of bill payable after sight accepted for honor
- 167 Protest required where bill accepted for honor
- 168 Presentment for payment to acceptor for honor—how made
- 169 When delay in making presentment is excused
- 170 Dishonor of bill by acceptor for honor

§ 161 When bill may be accepted for honor —Where a bill of exchange has been protested for dishonor by non-acceptance or protested for better security, and is not overdue, any person not being a party already liable thereon may, with the consent of the holder, intervene and accept the bill *supra* protest for the honor of any party liable thereon, or for the honor of the person for whose account the bill is drawn. The acceptance for honor may be for part only of the sum for which the bill is drawn, and where there has been an acceptance for honor for one party, there may be a further acceptance by a different person for the honor of another party.

§ 162. How acceptance for honor made —An acceptance for honor *supra* protest must be in writing, and indicate that it is an acceptance for honor, and must be signed by the acceptor for honor.

§ 163 When deemed to be an acceptance for honor of the drawer —Where an acceptance for honor does not expressly state for whose honor it is made, it is deemed to be an acceptance for the honor of the drawer.

§ 164 Liability of acceptor for honor —The acceptor for honor is liable to the holder and to all parties to the bill subsequent to the party for whose honor he has accepted.

§ 165 Agreement of acceptor for honor —The acceptor for honor by such acceptance engages that he will on due presentment pay the bill according to the terms of his acceptance, provided it shall not have been paid by the drawee, and provided also, that it shall have been duly presented for payment and protested for non-payment and notice of dishonor given to him.

§ 166 Maturity of bill payable after sight and accepted for honor —Where a bill payable after sight is accepted for honor, its maturity is calculated from the date of the noting for non-acceptance and not from the date of the acceptance for honor.

§ 167 Protest required where bill accepted for honor —Where a dishonored bill has been accepted for honor *supra* protest or contains a reference in case of need, it must be protested for non-payment before it is presented for payment to the acceptor for honor or referee in case of need.

§ 168 Presentment for payment to acceptor for honor—how made —Presentment for payment to the acceptor for honor must be made as follows

- 1 If it is to be presented in the place where the protest for non-pay-

ment was made, it must be presented not later than the day following its maturity,.)

2 If it is to be presented in some other place than the place where it was protested, then it must be forwarded within the time specified in section one hundred and four

§ 169. When delay in making presentment is excused—The provisions of section eighty-one apply where there is delay in making presentment to the acceptor for honor or referee in case of need

§ 170 Dishonor of bill by acceptor for honor—When the bill is dishonored by the acceptor for honor it must be protested for non-payment by him

PAYMENT FOR HONOR

Section 171 Who may make payment for honor

172 Payment to be attested by notary

173 Declaration before payment for honor

174 Preference of parties offering to pay for honor

175 Effect of payment—subsequent parties—rights of payer for honor

176 Where holder refuses to receive payment supra protest

177 Payer entitled to bill and protest

§ 171. Who may make payment for honor—Where a bill has been protested for non-payment, any person may intervene and pay it supra protest for the honor of any person liable thereon or for the honor of the person for whose account it was drawn

§ 172 Payment to be attested by notary—The payment for honor supra protest in order to operate as such and not as a mere voluntary payment must be attested by a notarial act of honor, which may be appended to the protest or form an extension to it

§ 173. Declaration before payment for honor—The notarial act of honor must be founded on a declaration made by the payer for honor, or by his agent in that behalf declaring his intention to pay the bill for honor and for whose honor he pays

§ 174 Preference of parties offering to pay for honor—Where two or more persons offer to pay a bill for the honor of different parties, the person whose payment will discharge most parties to the bill is to be given the preference

§ 175 Effect of payment—subsequent parties—rights of payee for honor—Where a bill has been paid for honor, all parties subsequent to the party for whose honor it is paid are discharged, but the payer for honor is subrogated for, and succeeds to, both the rights and duties of the holder as regards the party for whose honor he pays and all parties liable to the latter

§ 176. Where holder refuses to receive payment *supra protest*—Where the holder of a bill refuses to receive payment *supra protest*, he loses his right of recourse against any party who would have been discharged by such payment

§ 177 Payer entitled to bill and protest—The payer for honor, on paying to the holder the amount of the bill and the notarial expenses incidental to its dishonor, is entitled to receive both the bill itself and the protest

BILLS IN A SET

- Section 178 All the parts constitute one bill
 179 Rights of holders where different parts are negotiated
 180 Liability of holder who indorses two or more parts of a set to different persons
 181 Acceptance of bills drawn in sets
 182 Payment by acceptor of bills drawn in sets
 183 Effect of discharging one of a set

§ 178. All the parts constitute one bill—Where a bill is drawn in a set, each part of the set being numbered and containing a reference to the other parts, the whole of the parts constitute one bill

§ 179 Rights of holders where different parts are negotiated.—Where two or more parts of a set are negotiated to different holders in due course, the holder whose title first accrues is as between such holders the true owner of the bill. But nothing in this section affects the rights of a person who in due course accepts or pays the part first presented to him.

§ 180. Liability of holder who indorses two or more parts of a set to different persons.—Where the holder of a set indorses two or more parts to different persons he is liable on every such part, and every indorser subsequent to him is liable on the part he has himself indorsed, as if such parts were separate bills.

§ 181. Acceptance of bills drawn in sets—The acceptance may be written on any part, and it must be written on one part only. If the drawee accepts more than one part, and such accepted parts are negotiated to different holders in due course, he is liable on every such part as if it were a separate bill.

§ 182 Payment by acceptor of bills drawn in sets—When the acceptor of a bill drawn in a set pays it without requiring the part bearing his acceptance to be delivered up to him, and that part at maturity is outstanding in the hands of a holder in due course, he is liable to the holder thereon.

§ 183 Effect of discharging one of a set—Except as herein otherwise provided, where any one part of a bill drawn in a set is discharged by payment or otherwise the whole bill is discharged.

PROMISSORY NOTES AND CHECKS

- Section 184 Promissory note defined
185 Check defined
186 Within what time a check must be presented
187 Certification of check—effect of
188 Effect where holder of check procures it to be certified
189 Check does not operate as an assignment

§ 184 Promissory note defined—A negotiable promissory note within the meaning of this act is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer. Where a note is drawn to the maker's own order, it is not complete until indorsed by him.

§ 185. Check defined—A check is a bill of exchange drawn on a bank payable on demand. Except as herein otherwise provided, the provisions of this act applicable to a bill of exchange payable on demand apply to a check.

§ 186 Within what time a check must be presented.—A check must be presented for payment within a reasonable time after its issue or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay.

§ 187. Certification of check—effect of—Where a check is certified by the bank on which it is drawn the certification is equivalent to an acceptance.

§ 188. Effect where the holder of check procures it to be certified—Where the holder of a check procures it to be accepted or certified the drawer and all indorsers are discharged from liability thereon.

§ 189 Check does not operate as an assignment.—A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check.

§ 190 This act shall be known as the Negotiable Instruments Law.

§ 191 Definitions and meaning of terms—In this act, unless the context otherwise requires

"Acceptance" means an acceptance completed by delivery or notification.

"Action" includes counter-claim and set-off.

"Bank" includes any person or association of persons carrying on the business of banking, whether incorporated or not.

"Bearer" means the person in possession of a bill or note which is payable to bearer.

"Bill" means bill of exchange, and "note" means negotiable promissory note.

"Delivery" means transfer of possession, actual or constructive, from one person to another

"Holder" means the payee or indorsee of a bill or note, who is in possession of it, or the bearer thereof

"Indorsement" means an indorsement completed by delivery

"Instrument" means negotiable instrument

"Issue" means the first delivery of the instrument, complete in form, to a person who takes it as a holder

"Person" includes a body of persons, whether incorporated or not

"Value" means valuable consideration

"Written" includes printed, and "writing" includes print

§ 192 Primary and secondary liability—The person "primarily" liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same. All other parties are "secondarily" liable

§ 193. Reasonable time—what constitutes.—In determining what is a "reasonable time" or an "unreasonable time," regard is to be had to the nature of the instrument, the usage of trade or business (if any) with respect to such instruments, and the facts of the particular case

§ 194. When time for doing act falls on Sunday or holiday—Where the day, or the last day, for doing any act herein required or permitted to be done falls on Sunday or on a holiday, the act may be done on the next succeeding secular or business day

§ 195. Instruments made prior to act—The provisions of this act do not apply to negotiable instruments made and delivered prior to the passage hereof

§ 196. Cases not provided for in act—In any case not provided for in this act the rules of the law merchant shall govern

§ 326 Recovery of forged check—No bank shall be liable to a depositor for the payment by it of a forged or raised check, unless within one year after the return to the depositor of the voucher of such payment, such depositor shall notify the bank that the check so paid was forged or raised

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